MANY misconceptions have arisen in the public mind concerning the purpose and functions of a stock exchange, and the term is often associated mainly with the idea of risky financial speculation. But as the writer of this volume points out, 'stock exchange' is an honest term for the place where stocks and shares are bought and sold as a means to the organization and control of the art of investment. The coming of a vast mass of government securities of different dates and denominations has tended to make the work of the London Stock Exchange more necessary than ever before to the Chancellor of the Exchequer and the Treasury, as well as to the investing public. The author, a former editor of *The Economist*, has brought his useful little book up to date for this edition.

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5

THE STOCK EXCHANGE

The Stock Exchange

A SHORT STUDY OF INVESTMENT
AND SPECULATION

FRANCIS W. HIRST

Fourth Edition

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PREFACE TO THE FOURTH EDITION

THIS book, written at the request of my old friend the late H. A. L. Fisher, was first published in 1911. A revised edition followed in 1913, and several impressions were called for between the two Great Wars. Then came the financial and economic blizzard, which started with the Wall Street collapse in the autumn of 1929. It happened that I was then in the United States, and stayed for a time at the White House with Mr. Herbert C. Hoover, then President of the United States, when the disastrous economic results of a Stock Exchange disaster, which communicated itself to Stock Exchanges and banks in Europe and South America, were beginning to reveal themselves.

The ultimate consequences in Great Britain are now ancient history. The Labour Government was replaced by a Coalition Government, and Philip Snowden in his last Budget, by economies and increased taxation, overcame the large deficit, but was unable to save the gold currency. The Bank of England stopped payments in gold; and the Government reverted to the managed inconvertible paper currency, which had been adopted in 1914, at the beginning of the first World War. There followed a complete reversal of the free trade policy which had been inaugurated by Sir Robert Peel ninety years before. The new system was carried out by the MacDonald Government, with Mr. Neville Chamberlain as Chancellor

of the Exchequer and Mr. Runciman as President of the Board of Trade, in the Import Duties Act, with preferences negotiated at Ottawa for the British Empire in 1932; but gradually—though unemployment remained very heavy for several years—the financial situation soon became easier; our Joint Stock Banks functioned normally, and the London Stock Exchange after a time emerged from most of its difficulties, though its brokers and jobbers, as well as their clients, were hard hit by the failures abroad and the numerous defaults of governments and companies, in which British investors had placed many hundreds of millions.

It was far otherwise in the United States. When President Roosevelt took office the American banking system, as well as the Stock Exchanges, had ceased to operate. A very large number of banks had been ruined by the speculative mania. These were closed, and a series of measures known as 'the New Deal' was initiated and carried through by President Roosevelt before the United States became involved through Japanese aggression in the second World War. By that time most of our overseas securities had been pawned, and most of our gold had been exported to the United States. But Lend-Lease came to the rescue, and in the summer of this year, 1946, after many months of negotiation, President Truman obtained the support of Congress for a large loan, free of interest for five years, which, it is hoped, will enable us to recover our commerce and get free eventually from the controls and restrictions on home markets and prices which were imposed during the War.

How long it will take before the London and provincial Stock Exchanges are able to play their old part in speculative investment it is impossible to predict. But an objective account of what has happened and of the actual situation in the summer of 1946 has been added in a concluding chapter.

After several years' discussion a scheme for unified control of the London Stock Exchange has been adopted recently.

F. W. H.

December 1947

Preface to the Third Edition

Since this book was first written, the financial world has been shaken to its foundations by the costliest war in human history. Many states passed through the bankruptcy court, but a stupendous load of War Debts and Indemnities remained to prevent half-ruined nations from struggling on to their feet. During 1931 Germany proclaimed a moratorium; other countries defaulted on their debts; and at length, when nearly three-fourths of the world's monetary gold stock had been drained away to New York and Paris, a flood of foreign liquidation poured upon London; the Bank of England's gold reserve was dangerously depleted, and Great Britain was driven off the gold standard. Nevertheless, in revising this book, I have realized that in essential features the London Stock Exchange has not altered since 1911, when it was first published. The volume of securities dealt in on the London Stock Exchange has been swollen enormously by War Loans, while the share values of many once flourishing companies have dwindled to nothing; yet it may be affirmed that neither the theory nor the practice of investment and speculation has undergone any vital modification in the last twenty years. Economic laws survive their violation. The fabric of society is being patched up, and peoples are regaining most of their old habits and practices. Like other primitive instincts of the human race, the passion

for speculative gaming seems to outlast every cataclysm of society and every revolution of Government. In a description of Germany and the German tribes during the first century of the Roman Empire, Gibbon has drawn a sardonic picture of the life some ancestors of ours led in the German forests:

> In the dull intervals of peace these barbarians were immoderately addicted to deep gaming and excessive drinking; both of which, by different means, the one by inflaming their passions, the other by extinguishing their reason, alike relieved them from the pain of thinking. They gloried in passing whole days and nights at table; and the blood of friends and relations often stained their numerous and drunken assemblies. Their debts of honour (for in that light they have transmitted to us those of play) they discharged with the most romantic fidelity. The desperate gamester, who had staked his person and liberty on a last throw of the dice, patiently submitted to the decision of fortune, and suffered himself to be bound, chastised, and sold into remote slavery, by his weaker but more lucky antagonist.

The Germans, he added, may have borrowed the *arts* of play from the Romans, 'but the *passion* is wonderfully inherent in the human species'.

If the philosophic historian could have revisited the earth in 1931, he might have reflected further on the strength of this ineradicable propensity of mankind, which, after all the experiences of the Great War—a war that shattered the credit and currencies of so many nations, converting thousands of millions of gilt-edged securities into waste paper —nevertheless revived so powerfully within a

decade that it could create in the United States the greatest of speculative manias followed by the most disastrous collapse on record. Readers of this book will easily understand how the institution of Stock Exchanges and Bourses has not only provided invaluable facilities for both thrift and enterprise, but has also supplied a sometimes dangerous outlet for the gaming vices that amused and thrilled our rude ancestors in the Hercynian forest. Some, I hope, may be led on to inquire further how the Wall Street slump in the autumn of 1919 helped to spread a ruinous depression over the whole civilized world.

These two disasters—the Great War of 1914 and the great slump of 1929—have left a deep impression, not only on national and international finance, not only on currency and banking and taxes and prices, but on the volume and valuation of Stock Exchange securities everywhere. Upon the first—whose economic consequences have been admirably sketched by Professor Bowley in a recent volume of this series—I need not enlarge. It will be enough if we remind ourselves that the debts and currencies of all the European belligerents were inflated to such a degree that Great Britain alone was able to restore public credit without repudiating or confiscating any portion of its War Debt, though we have lost or remitted most of the vast sums lent to our Allies.

The second disaster, though incomparably smaller than the first when measured in terms of human suffering, has wrought terrible havoc, not only in the United States, but in all debtor countries

which were still staggering under a load of gold debts and indemnities; for, since the collapse of the Wall Street boom, trade depression and falling prices have made the weight of taxes and the service of gold loans insupportable. Thus another violent shock has been administered to a world trembling with unstable currencies and dislocated exchanges—a world in which business and employment are the sport of tariffs, embargoes, subsidies, restrictions, and countless schemes for preventing or obstructing the natural flow and interchange of commodities and services.

Amid this welter of confusion and economic suffering, Stock Exchanges and Bourses still play their indispensable part, though many have from time to time been closed or fettered during the War, and again in this year of general distrust and distress.

In none of the world's financial institutions have these post-War conditions been more faithfully and fully reflected than in the markets and market-quotations of the London Stock Exchange.

F. W. H.

November 1931

CONTENTS

INTRODUCTION

In an old Pennsylvanian almanac of the eighteenth century two qualities were postulated for success in business: first, application or industry, and second, thrift or frugality. The first without the second often leads to nothing. 'A man if he knows not how to save as he gets, may keep his nose all his life to the grindstone, and die not worth a groat at last.' The old proverb, *A fat kitchen makes a lean will*, should remind us moderns that not only excess in eating and drinking, but luxurious and expensive follies of all kinds may drive the hardest worker into debt and difficulty, until after long enjoyment of a good income he ends his career in poverty and dependence. This book is not concerned, however, with the moral value of thrift, or even with the advantages which savings bestow upon the individual. Without savings indeed, or without an inherited fortune, no one can feel quite independent. That is a strong and sufficient moral ground for not spending all that one earns. But our particular business is neither with the first process of earning, nor with the second of saving, but with a third. We have to consider neither the making nor the saving of money, but its investment after it has been earned and saved. 'Investment' is a comparatively new word; it was not known to Dr. Johnson as a financial term, and many of the investor's facilities are essentially modern. Nor does our subject allow us to treat of all investments,

it confines us to investment in Stock Exchange Securities.

But it is important to bear in mind throughout that the accumulation of wealth, and the reduction of poverty, and all the means by which material comforts and conveniences are multiplied, by which the arts flourish, by which letters and learning are spread through all ranks of society, depend ultimately on the thrift and savings of individuals, aided by an efficient and economical Government. That the virtue of saving is easy for the rich and difficult for the poor must be confessed; that it is sometimes morally and economically right to spend all one's income and even to borrow may be admitted. But, nevertheless, progress depends upon saving. Banks and Stock Exchanges, which facilitate and encourage saving, are themselves the fruits of saving; without saving they could not have been called into existence. When capital shrinks, when the community they serve sinks into decay, these institutions likewise must come to grief. Invention and scientific discovery are constantly adding to the rewards of industry. War is the great destroyer of wealth. But for war, progress would be the rule and decay the exception in human societies.

The art of making money is a mystery which cannot be taught; and though many books have been written with prescriptions for acquiring a fortune, few men have ever made themselves a penny the richer by reading them. But the art of keeping money after you have made it, and of increasing your surplus capital by judicious

investments, can be learnt. Any person with prudence and self-restraint can in ordinary times and circumstances secure himself against serious capital depreciation, and obtain a steady dividend on the moneys he has been able to put by from time to time. This was not always so. In fact, until the last century property and trade were so insecure, even in the most settled and civilized countries, that a man who had saved money was often at a loss what to do. He might have to choose between spending it and hiding it away. The miser, who hoarded his gold, because he could not trust it out of his sight, was to be found side by side with the Jew, who lent it out at exorbitant rates of interest, calculating that he would gain in usury from those who paid more than he lost in bad debts. Pirates by sea, brigands on land, sovereigns and nobles who extorted loans only to repudiate them, governments which supplied their needs by debasing the coinage, or by issuing worthless paper money—these are but samples from the big bale of circumstances that made the accumulation and investment of wealth in olden times so difficult and hazardous.

But now, apart from the wonderful improvements in administration, justice, and police, the most skilful and successful burglar can no longer rob a rich man of his fortune. And why? Not because the police are more efficient, not because safes have been perfected, not because the art of thieving has decayed. No, simply and solely because the rich man no longer buries his gold. Hoarding before the Great War was obsolete in

England, and was becoming rare in most countries. But during the War it was revived, by bitter experience of depreciating paper money. In 1931, another wave of distrust in banks and securities swept over Europe and America. It drove sterling off the gold standard, and started hoarding on a large scale on the Continent and in America.

In the years before the War, hoarding was being superseded by two ingenious inventions, which made the disposal of savings incomparably simpler and easier. These were the bank and the Stock Exchange, or the cheque and the Stock Exchange security. In Britain and the United States almost everyone possessing a moderate income keeps a bank account, into which he deposits his earnings, and from which he draws his expenses. If he is of a thrifty disposition, he lives well within his income; and when his balance at the bank grows larger than is necessary he will pick out a security and instruct his banker or broker to buy it for him. This security may be a bond with coupons attached. The purchaser may keep the bond at home and cut off the coupons as they become due, sending them to his banker, who will exchange them for money, and add them to his balance at the bank. More usually he will deposit his security at a bank, leaving the banker to look after his coupons and add them to his balance as they become due. Or he may have bought the registered stock of some public corporation or private company, in which case the dividend will be sent him regularly. The security, of course, is paid for by a cheque upon his bank, and the bank takes that

sum from his balance and hands it over to the broker, who buys the security and takes a small commission for his trouble. A hundred years ago the use of the cheque was hardly understood even in London, and an English country gentleman would have had infinitely more trouble in making a small investment than would nowadays a remote Australian squatter, or a wheat-grower in the wildest West of Canada. Two centuries ago, investment in the modern sense had hardly begun. The Bank of England had only been in existence for a short time, and there were no bankers, no brokers, and no Stock Exchange in the modern sense of the word. A man who wished to invest, without personally employing his capital, had practically no choice but to buy property and let it out at a rent, or lend his money on mortgage. Bank of England Stock or National Debt had just begun to be a political speculation for the moneyed Whigs in London. Merchant venturers might risk large sums in a joint-stock voyage. Otherwise an Englishman at the beginning of the eighteenth century A.D. was hardly better off for investment than an Athenian in the age of Pericles, or a Roman in the days of Cicero.

But modern inventions have brought dangers as well as securities. If by very hard work a thrifty person saves £100 or £1,000 one would expect him to take very good care of it. He need not be in any hurry. It will be perfectly safe, yielding him a modest interest, if he deposits it in a respectable bank or in the savings department of a post office. Unfortunately a natural passion for high interest,

or the promise of an increase in his capital too often makes him an easy prey to some plausible rogue, who has baited his hook with a worthless company's prospectus or shares. In a moment of weakness he draws a cheque, buys some unmarketable security, and the greater part if not the whole of his hard-earned savings is irrevocably lost. The fraudulent prospectuses, concealed advertisements and inspired tips in which many newspapers abound are so many traps and pitfalls for the unwary.

I have written this little book in the hope that at any rate a few thousands of readers may avoid such losses, and that some hundreds of thousands, perhaps millions, of pounds, which might have been sunk in fraudulent companies, may flow through honest hands into sound securities and profitable concerns. Wasteful expenditure and riotous living are often truly described as an ill feature of our age and country. But the reckless waste of savings through mere carelessness, imprudence or credulity may be more deplorable than the wasteful expenditure of income; for it often involves helpless widows and orphans in avoidable misery. With a little attention and common sense such losses can usually be foreseen and averted.

We shall be concerned mainly, as I have said, and as the title of the book implies, with investments in Stock Exchange securities, and more especially in the securities which are bought and sold on the London Stock Exchange. Every Stock Exchange has its own list of securities. Only a comparatively small number of stocks are international in the sense of being quoted at the same

time on the Exchanges of London, Paris, Berlin, Amsterdam, Brussels and New York. But London is the banking and financial centre of the world; nor can any territorial limit be set to British investments. Our merchants and shippers seek profit in every corner of the globe: our investors large and small have interests in every continent, and the London Stock Exchange List is in itself a sort of key to the distribution of British trade and capital. Hence an English book on the stock markets appeals directly to our American kinsmen in the United States, to Canadians, Australians and New Zealanders as well as to the peoples now drawn together in a United South Africa. It will, therefore, be proper within a small compass to take a wide view; for, as Burke said, 'Great empires and little minds go ill together.'

But while this is the main purpose, I have aimed incidentally at bringing to bear upon this subject the teachings of history. The stock markets of to-day are not only more interesting but far more intelligible if we can approach them with the lantern of experience in our hand. Those who understand a business or an institution best are those who have made it or grown up with it. The next best thing is to learn how it has grown up, and then watch or take part in its actual working.

With some of the opinions expressed in later chapters the readers will often disagree. Many of them are drawn less from books than from conversation and observation. Every genuine attempt to portray the complex conditions of modern business life must fail in a greater or less degree.

The colouring will be too bright here, and there too sombre. Something material will be left out. Some expressions may be too strong, and some factors may be over-emphasized. Perhaps I may be accused of a certain bias in favour of the investor and of the general public. To this charge I plead guilty. At the same time I would beg to assure the reader that he and I have no better friends than those first-class bankers, brokers, dealers and promoters of sound new undertakings who practise callings so useful and so indispensable with such scrupulous integrity and such consummate ability in the great financial and commercial centres of the world.

CHAPTER I

THE EARLY HISTORY OF BANKING AND STOCK-JOBBING

Stock Exchange is an honest term. It means exactly what you would expect. Just as the Corn Exchange is a place where corn is bought and sold, so a Stock Exchange is a place where stocks are exchanged, or, if you like, where stocks and shares are bought and sold. It is as familiar to the modern business world as a bank, and in the great commercial capitals, where credit and speculation are focused, the two are invariably found together. In London the Stock Exchange lies alongside the Bank of England, and round them within a quarter of a mile are clustered hundreds of British, foreign, and colonial banks, exchange houses, discount houses, and financial institutions of every sort and kind. So in New York. There the great banks and financial houses congregate about Wall Street in a fashion that might point rather to their dependence upon the Stock Exchange than to the dependence of the Stock Exchange upon them. Wall Street, in fact, suggests a blend of banking and speculation.

But two centuries ago there were few banks and no Stock Exchanges. If we go back only a century our London Stock Exchange was but a struggling institution, a weakling in its cradle, despised and disliked by turns, often threatened with extinction by Parliament. Since then banks, bourses, stock

exchanges as well as money and discount markets have developed so marvellously that to-day[1] it would be hard to find a great city in the whole world whose merchants and investors are not better provided with facilities than were the wealthy citizens of London in 1831. A contrast so remarkable may well set us thinking and lead us towards an explanation of the problem we have to solve. For the Stock Exchange does not stand alone; it is not an isolated phenomenon: it is an item in the catalogue of progress, like the post and the railway, the telegraph and the telephone, motor vehicles, aeroplanes and wireless. Material progress and advancement are made up of many parts all hanging together. Banks and Stock Exchanges could not possibly be what they are without one another, or without a hundred other inventions. For example, what would a bank or a Stock Exchange be without a post office? And what would a post office be without railways, steamers and telegraphs? And how could we have had railways and telegraphs if steam power and electricity had not been discovered and applied?

But, though the wonderful inventions that have made the modern system of rapid travel and instantaneous communication are responsible for an equally wonderful system of international commerce and finance, I do not pretend that a Stock Exchange would be impossible without the railway and the telegraph.[2] In fact, the London

[1] This was written in 1911.

[2] And now (1946) the highways and airways, thanks to the internal combustion engine, are as important as railways.

Stock Exchange was founded before either was known. All that is really necessary to make a Stock Exchange is a sufficient quantity of stocks and shares and a sufficient number of investors or speculators desirous of buying and selling this sort of commodity. Indeed the philosopher, looking back to the civilization of ancient Greece and Rome, may well wonder why, with their baths, their theatres, their courts of law, their shops and markets and banks, Athens and Rome never invented or possessed a Stock Exchange. But this is only another way of expressing surprise that the convenient device of translating capital and debts into terms of interest-bearing paper was not invented until comparatively recent times.

Interest-bearing paper, in the sense of Stock Exchange securities, was part of a contrivance of the moneyed interest to finance the Continental wars of William of Orange. But William's was not the first needy Government that would have welcomed any plan for raising supplies at the expense of posterity.

Money, of course, and money-lending can be traced back far beyond the Christian era. Athenian lawyers in the days of Demosthenes argued about mortgages on land and ships. But an investor could not take shares in a company or lend money to the State by putting a talent into Greek *bonds*. There were no Italian *rentes* for a Roman citizen to buy with a bag of coins bearing Caesar's image and superscription. Among the modern causes of material progress, so remarkably rapid in the half-century which preceded the War of 1914, I am

inclined to think that an improvement of money, a development of credit and a multiplication of investments (three closely connected facts) played a decisive part. The establishment of sound and honest money comes first; for without this there can be no confidence, and without confidence trade cannot flourish and wealth cannot accumulate. That is clear from the bitter experience of the last few years.

When Europe began to wake from the dark centuries that followed the fall of the Roman Empire, Italy took the lead not only in the renaissance of art and learning, but also in commerce. The Bank of Venice is supposed to have been founded in 1157. In the fourteenth century the Florentines forged ahead, and the Bank of the Medici became the financial centre of what little financial intercourse and commerce then existed between the principal nations. In 1401 a bank was founded at Barcelona, and in 1407 the Republic of Genoa, being embarrassed by a multitude of loans, consolidated them into a 'mountain' (*monte*) and made this heap of debt the capital of a bank which was placed under the management of eight directors elected by the holders of the debt or stock. Various cities and territories belonging to Genoa were made over to the bank as security for the debt. The fame and success of the Italian banks led to the foundation of small lending houses in other countries by Lombard merchants. Quite a number settled in London, and gave their name to Lombard Street. As the Italian cities declined those of Germany and Northern Europe rose,

and the Hanseatic League flourished during the fifteenth and sixteenth centuries. Then Holland shook off the Spanish yoke and forged a new link between freedom and wealth. The famous Bank of Amsterdam was founded in 1609. Its prime purpose was to provide a good mercantile currency to remedy the evils of worn and clipped coins, which harassed merchants everywhere and embarrassed specially the trade between Holland and other countries. Already the Dutch were becoming the principal carriers and merchants of Northern Europe. The bank established this predominance. It received bad coins at very nearly their intrinsic value, issuing coin of standard weight and fineness in return. At the same time it was enacted that all foreign bills of exchange drawn upon, or negotiated at, Amsterdam of the value of more than 600 guilders should be paid in bank money. Thus the value of bills on Holland was raised abroad, and foreign merchants found it convenient to keep an account at the Bank of Amsterdam, so that they might have legal money to buy foreign bills. The bank was the property of the city and was under the control of four burgomasters. It was founded on the principle of providing good money for the finance of foreign trade in the freest and most prosperous commercial port. It was also a bank of deposit, and as such carried to considerable perfection the principle of written transfer. Any person who chose to lodge money in the bank might transfer it from his own name to that of another; and the law, as we have seen, required foreign bills of exchange to be paid by such transfers. The

device is really the same as that by which a business transaction between two persons who have accounts at the same bank is now settled. One draws a cheque in favour of the other. The amount of money at the bank remains the same, but some of it is transferred in the bank's book from the name of the customer who drew the cheque to that of the other who endorsed it. Thus there is a transfer of money without any actual movement of cash.

The Bank of Amsterdam flourished for a hundred and fifty years. Its fall was brought about by the misconduct of its directors, preceded and followed by a relative decline in the commerce of Holland, which yielded to the growing strength of England.

For some centuries England had lagged behind in developing the mechanism of money and exchange. The profitable business of money-changing was monopolized by Henry the First, John, Edward the Third, and some of their successors, who established the office of Royal Exchanger in London at Old Change near St. Paul's, and in other towns. This official had the exclusive privilege of exchanging gold coins for silver, and foreign for English money. The king farmed out the office, or shared in the profits, and the office in each town was called the Exchange, a name still attached to many of the covered markets where merchants meet to buy and sell and speculate in particular commodities such as wool, cotton, corn, as well as in stocks and shares. The office, which had fallen into disuse, was revived by a proclamation of Charles the First, much to the dissatisfaction of the goldsmiths, who had been

making good profits by culling out heavy coins for melting or for sale to the Dutch mint. The Goldsmiths' Company and the Common Council appealed in vain against this ordinance; but after the Commonwealth was established the business of money-changing fell again into the hands of the goldsmiths. Another trade, that of money-lending, was monopolized by the Jews from the Conquest until their expulsion in 1290, when the Lombards succeeded to the craft and proved equally usurious, their rates being proportioned to their risks. There was also a legal rate of interest—10 per cent. from 1571 to 1624, then 8 till 1651, and 6 till 1714, after which it was fixed at 5 for England, and 6 for Ireland. The term 'usury' denoted any rate of interest above that which the law sanctioned and enforced. After Charles the First's time the goldsmiths became the principal lenders and dealers in money, though reinforced by the Jews whom Cromwell readmitted to England. Then, as Gilbart, the classical authority on English banking, explains, a new era began in the history of banking:

> The goldsmiths, who were previously only money-changers, now became also money-borrowers, and allowed interest on the sums they borrowed. They were agents for receiving rents. They lent money to the king on the security of the taxes. The receipts they issued for the money lodged at their houses circulated from hand to hand, and were known by the name of *Goldsmiths' Notes*. These may be considered as the first kind of banknotes issued in England.

The banking goldsmiths made way rapidly, and attracted large quantities of cash, which enabled

them to advance money to Cromwell and Charles the Second at high rates in advance of the revenues. These 'new-fashioned bankers' were sharply criticized by the pamphleteers, and even by Sir Josiah Child, for draining away money from the country to London and preventing its investment in land. Here, in fact, we have a small beginning of the modern system of investment by deposit in banks. After the Restoration, it is written, 'King Charles the Second being in want of money, these goldsmith bankers took 10 per cent. of him barefacedly and by private contracts. On many bills, orders, tallies and debts of that king they got 20, sometimes 30 per cent. to the great dishonour of the Government.' In 1667, when the Dutch fleet sailed up the Thames, set fire to Chatham, and burnt four ships of the line, there occurred the first recorded 'run' on our banks. The alarm was allayed by a royal proclamation promising that the payments to the bankers should be made as usual from the Exchequer. But in 1672 the Exchequer was closed and the king repudiated a debt of £1,328,526 which he had borrowed of the goldsmiths at 8 per cent. This shameless act caused wide distress. 'Not merchants only, but widows, orphans and others became suddenly deprived of the whole of their property. They came in crowds to the bankers, but could obtain neither the principal nor the interest of the money they had deposited.'

After a time the king compounded. He refused to repay the principal, but granted a patent to pay 6 per cent. interest out of his hereditary excise.

Then after six years he again suspended payment. This Goldsmiths' Debt, or Bankers' Debt, was reconsidered in the years following the Revolution, and after some litigation the claims of the creditors were partially recognized.

We are now brought to the foundation of the Bank of England, which coincides with the first chapter in the English History of Stocks and Stock Jobbing—a development much hated by the old Jacobites and Tories. They called it 'Dutch finance', and their prejudice was justified partly by political, partly by economic, and partly by moral considerations. Politically they hated the Bank and the Stock which it issued, because it supplied the Government with money; for the Government was the Whig Government, standing between the country and the return of the Stuarts. Economically they disliked both Bank and Debt, because easy borrowing meant heavy expenditure on war, and an increase of taxes, principally on land, to pay the growing interest on the debt. Morally and socially they hated the new 'Dutch finance', because it stimulated speculation, and increased the power of London and of the moneyed interest at the expense of the country gentlemen. But the new system with all its evils had come to stay, and was destined not only to make many fortunes and bankruptcies, but also to give a marvellous impetus to the growth of credit, trade and capital. What happened has been often told, and for our purpose it is enough to retell the story very briefly.

During the seventeenth century our kings

generally borrowed by means of Exchequer tallies, which were acknowledgements of sums paid by private lenders to the Exchequer. The tally was a willow stick four or five feet long and about one inch square. There were notches on one side to express the amount of the debt, and identical descriptions of the payment were written on two of the three vacant sides. The stick was split in half through the notches. One half was given to the person making payment into the Exchequer; the other half of the counter tally, or counterfoil, was kept at the Exchequer as a check. Here we have the origin of the modern cheque system of our banks; and in the United States the early spelling of 'check' is still adhered to. The Tally system, which was abolished in 1783, served the purpose of modern Treasury bills, enabling the Government to borrow small sums for short periods.

In 1694 the Bank of England was founded. It was the project of William Paterson, a clever but speculative Scot, who afterwards came to grief in the Darien enterprise. It was the first of our joint-stock banks, and though not the first of our joint-stock companies, it gave the first opportunity for general dealings in stocks and shares. The scheme commended itself to Montagu—a Whig statesman of great financial ability—as a means of raising money; and the Government granted a charter to the Bank on condition that the Bank should lend the whole of its original capital (£1,200,000) to the Government, receiving in return (1) £96,000 annually, i.e. 8 per cent. interest plus £4,000 for management, (2) the right to issue notes to the

extent of £1,200,000 and (3) the right to do banking business. In plan, therefore, and original purpose the Bank of England resembles the Bank of Genoa rather than the Bank of Amsterdam. At first all went well. The tallies, which had been at a heavy discount, soon rose to par. But in 1696 the Bank failed in an attempt to carry out a recoinage, the currency then being in a very bad state. A suspension of payments followed with a depreciation of bank-notes and Exchequer tallies; but the Bank's credit was restored with the aid of the Government. In the following year the Government had to borrow another million, which was added to the Bank's capital with a corresponding increase of the note issue.

The National Debt was increasing rapidly. By 1711 the funded Debt had grown to £11,750,000, all of which was held by public investors as annuities, bank stock, East India Stock, etc., at various rates of interest. But there was also a huge unfunded debt which had grown to 9 millions in 1710. A new joint-stock company called the South Sea Company was promoted with the aid of Harley and St. John to take over this Debt. In return for this it was granted trading privileges, and to provide interest on its 9 millions of capital stock the Government assigned various duties on wine and beer and tobacco, etc. For ten years the South Sea Company engaged in the African Ocean trade and other ventures with little success. Then Sir John Blunt—one of the directors, a cunning and plausible scrivener—hatched another scheme, and by corrupt means won over Aislabie the Chancellor

of the Exchequer, and various other ministers and members of Parliament. The idea was taken from the famous Mississippi Company scheme of Law, which had burst over France with such disastrous ruin a year before. Undeterred by this example, Blunt boldly offered to take over the whole National Debt, amounting to 31 millions, if the Government would guarantee 5 per cent. interest for seven years and 4 per cent. thereafter in perpetuity. For some time the Bank of England and the South Sea Company bid against each other for the favour of the Government, but eventually the company's offer was accepted. The company then opened its first subscription of a million in £100 stock at £300. Blunt opportunely circulated a report that Gibraltar and Port Mahon would be exchanged with Spain for some places in Peru, whereby the South Sea trade would be protected and enlarged. Persons of all ranks crowded to South Sea House, and the stock went off like hot cakes. This was in April. By midsummer there was a second, and then a third subscription, accompanied by promises of more and more prodigious dividends. The City went mad; stock-jobbers ran from coffee-house to coffee-house inviting subscriptions to the great bubble and to little bubble companies of all descriptions. It was the first joint-stock mania.

All distinction of party, religion, sex, character, and circumstances [writes Smollett, the historian of the time] were swallowed up in this universal concern. Exchange Alley was filled with a strange concourse of statesmen and clergymen, churchmen and dissenters, Whigs and Tories, physicians, lawyers, tradesmen, and even with multitudes

of females. All other possessions and employments were utterly neglected; and the people's attention wholly engrossed by this and other chimerical schemes, which were known by the denomination of bubbles. New companies started up every day, under the countenance of the prime nobility. The Prince of Wales was constituted Governor of the Welsh copper company: the Duke of Chandos appeared at the head of the York buildings company: the Duke of Bridgewater formed a third, for building houses in London and Westminster.

The third South Sea subscription was £1,000 for £100 stock, and £2,000 was touched before September, when the stock began to fall. By 29 September it had sunk to £150. Several eminent bankers and goldsmiths, who had lent great sums on it, were forced to stop payment and abscond. The South Sea Bubble had burst. 'The ebb of this portentous tide was so violent that it bore down everything in its way; and an immense number of families were overwhelmed with ruin.' Walpole called in the aid of the Bank, but its resources were unequal to the emergency. The king was summoned back from Hanover; Parliament was assembled, and Walpole laid before it a wise scheme for restoring the public credit. A thorough inquiry was instituted and some severe punishments were meted out. So the curtain closed on this strange scene of national infatuation.

In the reaction that followed, the British public began to appreciate the value of gilt-edged securities, and the British Government, under the prudent guidance of Walpole, practised peace and economy. The public credit responded

marvellously. In Queen Anne's reign 6 per cent. had been the usual rate of interest on public loans. Within six years of the bubble—in 1726—a 3 per cent. Government stock of £10 lottery tickets was issued at par, and actually sold up to 107 in 1739. In the wars with Spain and France (1740–47) 30 millions more in new loans at various rates were added to the National Debt; but in the ensuing peace credit speedily revived, and in 1749 a successful scheme of conversion was effected by which the interest on most of the debt was reduced to 3 per cent.

Two funds were established, one being called the 3 per cent. consolidated annuities. Thus were created the world-famed British 'Consols' (i.e. consolidateds) which, through many fluctuations of credit, retained 'the sweet simplicity of 3 per cent.' for more than a century. After a short interval of peace London's stock and share markets were again flooded with Government paper by the Seven Years War (1756–63) which added 54 millions to the National Debt in lottery loans, bearing interest at 3, 3½, and 4 per cent. apart from the prizes. During the succeeding peace some debt was paid off, and some was converted from 4 per cent. to 3 per cent. But in 1776 the long War of American Independence broke out, and ten years later, when its financial consequences became clear, the National Debt was found to have been nearly doubled, having increased from 128 to 244 millions, while the charge for interest had more than doubled, having risen from £4,471,000 to £9,302,000.

At the Peace of Versailles, in 1783, the funded

debt consisted of £107,000,000, 3 per cent. consols, £37,000,000 3 per cent. reduced, £32,000,000 four per cents., and £17,000,000 fives, while a further 42 millions was owing to the Bank, to the East India and South Sea Companies, and to the Civil List. After another breathing space the country was launched upon the war of the French Revolution. Just before its commencement in 1793 the funded debt amounted to about 228 millions with an interest charge of about 7½ millions, and the unfunded or floating debt was 16 millions, with an interest charge of just under half a million. At the conclusion of peace in 1815, according to the computation of Robert Hamilton, the National Debt had run up to what then seemed the appalling total of 758 millions, and the charge for interest and annuities was £27,652,000. No wonder that in this last period the London Stock Exchange had become an important institution, or that great fortunes had been made by contractors and loan-mongers of all descriptions. No wonder either that the country was submerged in pauperism and its Government fast approaching a state of bankruptcy.

From this brief account of the National Debt, which must have absorbed a very great part of the national savings from 1700 up to the year 1815, we may return to stock-jobbing, with which, as has been seen, the origin and expansion of our national war loans are so intimately and even inseparably associated. It has been shown how during the South Sea Bubble speculation ran through all ranks of London society. But the boom in South

Sea Stock had, as it were, a gilt-edged basis in the favour and support of the Government. Harley, as Chancellor of the Exchequer, had been Governor, and one of the original directors was St. John (Viscount Bolingbroke). In the huge swindle of 1720 Aislabie, the Chancellor of the Exchequer, and Lord Sunderland, who represented the Ministry in the House of Lords, were deeply implicated. No wonder, then, that rank and fashion led that wild rush of speculators to Change Alley. A ballad-monger of the time tells how the stars and garters vied with the meaner rabble—

> To buy and sell, to see and hear
> The Jews and Gentiles squabble,

and how 'the greatest ladies'

> Plied in chariots daily,
> Or pawned their jewels for a sum
> To venture in the Alley.

In the reaction that followed stock-jobbing suffered discredit; but it was a genuine profession, meeting a new and genuine need. The public debt proved to be unextinguishable: the public funds grew so fast and fluctuated so rapidly under the influence of wars and rumours of wars that the quick-witted gentry of Change Alley and the coffee-houses found plenty of occupation. Private banks and joint-stock companies were also multiplying. Even during the mushroom growths of the South Sea Boom two sound insurance companies which still exist—the London Assurance Corporation and the Royal Exchange Assurance—found recognition

and capital. It may be asked where all the money came from. The answer is to be found in the fact, upon which we have been insisting, that these new interest-bearing securities gave employment to wealth that had previously lain idle. The practice of hoarding is not easily extirpated, and only yields to the gradual growth of confidence in the credit of Government, of banks, of brokers, and of established companies. It says much for the statesmen, the merchants, the bankers, and even the stock-jobbers of eighteenth-century London that money came out so freely in this very first epoch of investment. At the Revolution one fugitive is said to have carried his fortune of £20,000 away with him in a strong box. A generation later he would have taken it in bank-notes or negotiable stock.

The jobbers were long in housing themselves. At first they frequented the Royal Exchange and the Rotunda of the Bank, then the coffee-houses and the streets—Cornhill, Lombard Street and especially Change Alley and Sweetings Alley. Old Jonathan's Coffee-house was a favourite resort for those who preferred indoor comfort to the rough and tumble and exposure of Change Alley. It was burnt down in 1748. But New Jonathan's took its place, and, in July 1773, 'the brokers and others at New Jonathan's came to a resolution that, instead of its being called New Jonathan's it should be called The Stock Exchange, which is to be wrote over the door'. From this time London may be said to have possessed a Stock Exchange in the modern sense, though much business in the public

funds was still transacted at the Bank, and dealings in foreign securities still centred in the Royal Exchange. The members of Jonathan's paid a small subscription and eventually drew up rules, and appointed a committee of management. But daily admission could be gained by a payment of sixpence. At length the membership of brokers and jobbers outgrew the accommodation, and at the end of the eighteenth century it was determined to provide new quarters. A building was erected close to the Bank of England, in Capel Court, and opened in March 1802 with a membership of about five hundred. But this belongs to our next chapter. Here it only remains to add that the first Stock Exchange book was published in 1761. Its title ran: *Every man his own broker, or a Guide to Exchange Alley*. The author, J. Mortimer, was an economist of some merit. He had been British Consul in Holland and had seen the workings of the Amsterdam Bourse and the arbitrage business between London and Amsterdam, which was already considerable in the middle of the eighteenth century; for the Dutchmen were fond of speculating in the London market. Mortimer seems to have lost money in stocks, and the main purpose of his book is to warn the investing public and the Government against the jobbers. He therefore gives minute instructions to would-be investors in Government funds, showing them how to deal directly with the officials at the Bank of England. We shall have occasion in another chapter to refer to this interesting book, which ran to many editions. It shows that much of the slang and many

of the arts and tricks of speculation were already in vogue before the formation of the London Stock Exchange.[1]

[1] Before proceeding with the next chapter, readers unfamiliar with the subject should read the glossary at the end of the book (p. 218).

CHAPTER II

THE LONDON STOCK EXCHANGE, 1800–1931

At the desire of the Royal Commission of 1877 the officials of the London Stock Exchange supplied a short summary of the origin and objects of the institution. The secretary stated that the earliest minutes on the subject were dated December 1798, and that these records referred to the existence of a Stock Exchange in 1773—apparently the Stock Exchange Coffee-house in Threadneedle Street, to which any person was admitted on payment of sixpence. Already these rooms were known as 'the Stock Exchange', or 'the House'; and although transactions in the public funds were also carried on in the Rotunda of the Bank of England 'there is little doubt that the Stock Exchange Rooms afforded a ready market for the operations of the bankers, merchants and capitalists connected with the floating of the numerous loans raised at that period for the service of the State'. It is on record, continues this official authority, that the rooms were under the control of a 'committee for general purposes', though the expenses of management were defrayed by the voluntary subscription of frequenters. The functions of the committee were from the first, as they have since remained, 'judicial as regards the settlement of disputed bargains, and administrative as regards rules for the general

conduct of business, and for the liquidation of defaulters' accounts'.

Early in 1801 the rooms were felt to be inadequate for the increased business arising out of the war loans, and, moreover, 'it became apparent that the indiscriminate admission of the public was calculated to expose the dealers to the loss of valuable property'. This led to the establishment of a strict and privileged monopoly, resembling in some respects that of the law—brokers corresponding to solicitors and jobbers to barristers. A group of Stock Exchange men, having acquired 'a centrical situation', or site, in Capel Court, raised a capital of £20,000 in 400 shares of £50 each and founded a new institution, to which the affairs of the old rooms were ultimately transferred. The first stone of the new building was laid in May 1801. A committee for general purposes, consisting of thirty proprietors, was formed, who elected members of the new Stock Exchange by ballot, at a subscription of ten guineas each. The deed of settlement (27 March 1802) recites that, whereas the Stock Exchange in Threadneedle Street, where the stock-jobbers and stock-brokers met, had been found inconvenient, W. Hammond and others had secured a site, and had 'caused to be erected a spacious building for the transacting of buying and selling the public stocks or funds of this kingdom'. By the same deed the management, regulations, and direction of the new Stock Exchange were vested in a committee consisting of thirty members, or subscribers, to be chosen annually by ballot on 25 March, while the treasuryship

and management of the building were placed under the sole direction of nine trustees and managers (separate from the committee) as representatives of the proprietors. By this deed of settlement the London Stock Exchange was governed till 1876, when a new deed (substantially reproducing the original deed) was executed. The new Stock Exchange was opened in March 1802, with a list of about 500 subscribers. The regulations of the committee, whose main purpose was to ensure the prompt and regular adjustment of all transactions, were first codified and printed in 1812. They have, of course, been amended and enlarged from time to time to meet the new conditions and expansion of business.

The constitution of the Stock Exchange remains substantially unaltered, being still vested in two bodies — the managers and the committee, the former representing the shareholders or proprietors, and the latter the members or subscribers.[1]

The nine managers, or trustees (who are elected in threes for five years by the shareholders), fix the charges for admission of new members and appoint most of the officials, excepting, of course, the secretary to the committee. They also look after the building, and provide for heating, lighting, etc.

The committee, on the other hand, control all Stock Exchange business, and administer the rules and regulations; they adjudicate all questions between, and complaints against, members. They inquire, and decide, whether their rules have been

[1] See Chapter X for changes made since the second Great War.

complied with by governments and companies which ask for settlements or for official quotation of their stocks in the Stock Exchange List. Their number is thirty, and they are elected every year by the members. At the beginning of their term the committee elect a Chairman and Vice-Chairman. They also elect every March, before they go out of office, all the old Stock Exchange members who wish to be re-elected, membership being granted for one year only. Any member can object to any other member being re-elected, but this is a very unusual incident. The great principle upon which the committee acts, and to which most of its regulations are directed, is the inviolability of contracts. It has power to suspend or expel any member for breaking its rules, or for non-compliance with its decisions, or for dishonourable conduct. A member of the London Stock Exchange is prohibited from advertising or from sending circulars to any but his own clients. He is also forbidden to belong to any other Stock Exchange, or 'bucket shop', or other competing institution. The annual subscription for new members is either 50 or 100 guineas. The lower figures are applicable to clerks who have served four years in the House. It is also necessary to purchase a nomination, the price of which since the War has varied from a few pounds up to £1,800; but a clerk of four years' standing, who goes on to a waiting list, is not obliged to buy a nomination. A new member must obtain three sureties of £500 each for four years and acquire three Stock Exchange shares, while the clerk of four years' standing only requires two

sureties of £300 each and one Stock Exchange share. The membership of the Stock Exchange had risen to about 800 in 1845. In 1877 the members exceeded 2,000, and there were over 500 shareholders or proprietors. In 1910 its membership was over 5,000. In 1931 it had fallen back to about 4,000. Its capital consists of 20,000 shares with unlimited liability, of which only £36 per share has been paid up. The present dividend on each share is £13 per annum. With unimportant exceptions the shares can only be held by members.

A member of the London Stock Exchange, writing in the summer of 1931, described the interior of the House during business hours as follows:—

The gilt-edged market at the extreme west holds pride of place both for its importance and magnitude of dealings. In no other market can such enormous amounts be bought and sold without moving the price. Round this market congregate dealers in gas, water, shipping, bank and insurance shares, and Indian railway stocks. Going eastward, the gilt-edged market merges into the oil market, home railway market, and one corner of the industrial market which sprawls over a large portion of the House. The home railway market adjoins the Yankee market. During the day, many dealers in American and Canadian shares are scattered about the House; but when the American prices begin to arrive at 3 o'clock, these dealers assemble in a corner nearest the door leading to Shorter's Court, where are the Cable companies' offices. Dealers in electrical and brewery shares are also dotted about the House. On the eastern fringe of the industrial market come the foreign bond and rubber markets, and then the nitrate, iron and

steel, tea and South American railway markets. Finally, there is a large area given over to dealers in all kinds of mining shares—gold, tin, copper, silver, etc.

At first, as appears from the deed of settlement, the new Stock Exchange was confined to transactions in the funds. The jobbers in foreign stocks were excluded, and resorted mainly to the walks of the Royal Exchange. A certain amount of business in the funds continued for some time in the Rotunda of the Bank of England. Nor did the Alley men cease to ply their trade in the streets and coffee-houses. But after the close of the Napoleonic wars foreign loans and mining and canal shares were introduced into the new Stock Exchange; and as all these offered higher rates of interest at a time when the yield on Government loans was falling, the Stock Exchange obtained a large accession of business from the speculative public. This led, it is stated, 'to a proper apportionment of apartments for the dealing in English and foreign stocks'. One room was appropriated to British and another to foreign government stocks, and one corner of the foreign room was assigned to dealings in 'the shares and script certificates of the numberless companies which from time to time have been introduced'. The years 1824 and 1825 and 1826 saw a great outburst of speculation, which found vent in the flotation of many joint-stock projects as well as in an output of loans to the new republics of South America. This epoch marks the beginning of cosmopolitan finance, and even in a very rapid survey we can afford to pause and reflect upon

occurrences which have been repeated or substantially reproduced at intervals in all parts of the world.

In 'a complete view of joint-stock companies' formed in 1824 and 1825, the author, Henry English, enumerated 626 joint-stock projects which would have required for their fulfilment a capital, then inconceivably large, of 372 millions sterling! Their objects were various and for the most part useful. Some companies were to be formed for insurance and investment; others for the construction of canals and railways. Many were to be local gas companies, and there were mining flotations of all sorts.

Between 1818 and 1832—and especially in 1824 and 1825—there were also issued in London quite a number of foreign loans—in all perhaps some 40 millions sterling were subscribed in this way. According to a parliamentary paper, foreign government loans to a nominal value of 34 millions were contracted for by London houses at 23 millions, while foreign mining companies and similar liabilities, with a deposit of 10 per cent. paid, amounted to 24 millions. A table before me gives twenty-six foreign government loans in all for the period 1818 to 1832, and shows that of these only ten continued to pay interest in 1837. Of the ten survivors several defaulted a little later. All the good loans (and some of the bad ones) were issued either by N. W. Rothschild or by T. Wilson & Co. Among the curiosities of the list one notices that Neapolitan credit was much better than Prussian; for while Rothschild floated a Prussian

5 per cent. loan in 1818 at 72, the Neapolitan Fives six years later fetched 92½. In 1825 Ricardo sold Greek Fives to the public at 56½. In 1821 Haldimand issued a Spanish 5 per cent. loan at 56, and two years later J. Campbell & Co. issued another at 30¼! London was badly hit by the Spanish American Republics. In 1824 Baring Brothers contrived to issue £1,000,000 Buenos Aires Sixes at 85. Colombia actually raised, at 6 per cent., nearly 7 millions sterling of nominal debt, and at prices ranging from 84 to 88½. Questioned afterwards as to the causes of the boom and of the crisis which succeeded, a Governor of the Bank of England said he thought the speculative movement was started by the conversion and reduction of Government 5 per cents. in 1823. These reductions 'prompted almost everybody to entertain any proposition for investment, however absurd'. The excitement, he thought, 'was further promoted by the acknowledgement of South American Republics by this country, and the inducements held out to those governments, in which all classes of the community in England seem to have engaged simultaneously'. One foreign mining company was described later at its winding-up as 'one of the projects ventured in a period when it was thought the golden age had been realized, and when, without a proper consideration for the consequences, the public too eagerly encouraged the schemes of the day'. Commercial credit and the exchanges were at the same time disturbed by speculation in iron and other raw materials; and finally a crisis was precipitated by the failure of

Messrs. Pole & Co., an important London house with large country connexions. The strain must have been enormous; for according to James Wilson, the first editor and proprietor of the *Economist*, the total subscribed (i.e. promised) for foreign loans, mines, etc., in 1824–25 was 48 millions, and for home railways, banks, and other projects 126 millions, on which altogether only 35 millions were paid up! No wonder that a crash came.

After a decade of depression and quiescence, the Railway Mania gave a new start to speculation in shares. For some time the 'little go' for the sale of letters of allotment was held in the Royal Exchange before the merchants assembled. But at last the swarms of the 'little go' or 'Alley men' became such a nuisance that the beadles had to drive them out. In the height of this speculation, it is recorded—such was the distrust of steam locomotion—some of the 'dabblers' made a price of one farthing per share for 50 shares of what afterwards turned out to be one of the most important of English railways. Between 1834 and 1836, joint-stock companies with a total capital of 135 millions were formed, divided into more than 2½ million shares. New railway companies accounted for over 69 millions of capital with 590 thousand shares, banks for 23 millions capital and 670 thousand shares. Allowing an average of £3 for deposit on each share, the total sums raised were only just over 7¼ millions. This was too much for the market, which recovered only slowly from such an output of liabilities.

But the importance and profit-making capacity of the new iron roads began more and more to impress the public mind. Within twelve months of the first railway boom (1834) over 600 distinct projects for railway lines in the United Kingdom were placed before the public, demanding upwards of six hundred millions of money. But as five or six competing companies often asked parliamentary powers for practically the same line, the real capital required was very much smaller. In 1844 the actual capital of the British lines, which had been incorporated by statute and were in course of construction, was estimated at only 55 millions. Foreign railroad schemes also poured in to compete eagerly for British capital, and these again would have absorbed from seventy to a hundred millions sterling. As might have been supposed, these projects, actual and anticipatory, led to a great demand for, and a still greater speculation in, iron, which more than doubled in price and so magnified the difficulties occasioned by the inadequacy of available capital and credit. In a warning article, forecasting another crisis on the analogy of the previous one, which was published by the *Economist* in October 1845, the promotions and flotations of the three periods of speculation were thus compared and summarized in millions sterling:—

	Home Schemes.	Foreign.	Total.	Paid up and Deposits.
1824–25	156	48	204	35
1834–37	129	21	150	22
1844–45	612	79	691	78

At the time when this account was made up,

the premiums on railways, which had not yet secured an Act of Parliament, could not be estimated at less than 40 millions, which represented 'increased wealth hanging on opinion'. The *Economist*'s predictions and warnings proved correct, and the Stock Exchange panics and liquidations, which took place in the late autumn and winter of 1845–46, culminated in the money panic and banking crisis of October 1847.

An anonymous but well-informed writer affords us a glimpse of the Stock Exchange in 1845, at the height of the railway boom:

The share market, which, till within the last two years, was occupied with four or five distinct brokers and a number of jobbers, whose means of business were very small, has now become the grand focus of speculation and legitimate business. English and foreign government securities are quite deserted for the superior attractions of English and foreign Railway scrip, which, of all shades and character, has been freely distributed throughout the United Kingdom.

The brokers and jobbers who had the first 'pick' of the market must have made considerable sums by their commissions; since the other brokers and jobbers, who paid more attention to the other public securities, were almost discarded by their former customers, who, in many cases, were led to believe that the 'English and Foreign Stock' broker and jobber could not transact share business. Indeed, it appears to have been some time before the veil of mystery was removed, or that the public arrived at a clear understanding of the subject. In the meanwhile the old and respectable members of the House had the mortification to see persons, who formerly had been of little reputation in the Exchange,

and in many instances even their own clerks, carrying an on extensive and profitable business in shares; and as long as this lasted there was no end to the success of those who had the sway of the market. Gradually dealings were dispersed and spread among the whole of the fraternity, and then followed the height of speculation, engendered by the general operations of the chief part of the community. The shares of every new company coming out at a premium, induced rich and poor to thrust themselves into the market; and the schemes that are every day resorted to in order to gain possession of letters of allotment which may bring a price, if the shares be paid on, are of the most multifarious, and, in many instances, fraudulent description.

Such has been the increase of business in consequence of the speculation in shares that the accounts which used formerly to occupy not more than one or two days at the outside, nearly exhaust the week, before differences can be paid, transfers made, and the books of the brokers regularly adjusted. The extent of the transactions has increased beyond measure; night and day clerks are engaged in arranging sales and purchases, and conducting the correspondence which is required between their masters and principals.

Innumerable instances are stated of persons, who a few months ago were not worth anything, having made their thousands of pounds, and several of these are junior members of the House, who were fortunate enough to deal in those shares which have attained high premiums. Considering the time and attention required in share business, the brokers do not get too well paid; although there may be every reason to suppose that many are obtaining immense incomes from it by the inordinate influx of commissions. This will, we think, be seen when we state that the principal [part] of the business being transacted in the new scrip, upon which not more than

£1 to £3 has been paid, they only realize the small commission of 1s. 3d. per share. If they buy or sell largely of Brighton, Birmingham and Grand Junction, they get the larger commission; but these descriptions have not been dealt in to any comparable extent with the issues of the new companies. Brighton and South Eastern have undergone considerable fluctuation during the mania; but then, as the business was in a few hands, it cannot be supposed to have extended its beneficial influence over the whole market.

Some fortunate brokers were said to have made £3,000 and £4,000 a day by their business, but not, of course, by commissions. By lucky speculations they might easily have made much larger amounts. One fortunate individual outside the House, who held largely of Churnett Valley scrip before the announcement of the sanction of the Board of Trade to the project, 'sold at the best price of the market when the announcement was made, and netted by his one *coup* £27,000'. Very large sums were made and lost in London and York, and Direct Northern—two of the leading 'fancies' which were dealt in more for speculation than investment.

The number of American and foreign lines introduced on the London Stock Exchange added to the excitement prevailing. But, compared with the madness of 1825 and 1826, there was this much to be said for the railway mania of 1844–45—viz. that the new lines were undertakings of real utility and national importance, and though viewed at first with much jealousy and distrust, were already producing results which the most sanguine

had never counted on. Consequently, writes one sober critic, speculation in railway shares was encouraged not only as an investment likely to yield high rates of interest, but also for the benefit it confers on mankind at large.

The feasibility of the numerous schemes, and the elements of success they present, have, under these circumstances, raised an unanimous feeling in their favour, which, sanctioned as they have been by Government superintendence and Government interference, could not but contribute to feed the growing desire of the public to embark in them. The warnings that have been given have, therefore, not been regarded, and the mania has gone on to an extent almost unprecedented even by the great South Sea bubble itself.

The following criticism made by the same writer in 1845 was fully justified by events:

The feasibility of the greater number of the schemes brought before the public has encouraged the example of starting competing lines; while, in addition, foreign projects of the most questionable description have come out, the shares of which have maintained high premiums for a few days, and have then sunk into utter worthlessness. Among all this incongruous mass there must be part that will ripen to decay; and hence, while the stability of the system itself is acknowledged, it is that stability which has fostered many of the sham companies of the present day. When the crash does come it will be terrible. The best of the securities will feel it for a time, though restoration to a proper value will, no doubt, follow when the market shall have settled down and the web of ephemeral speculation be cleared away.

It is interesting to learn from the same source

that the swindling and blundering which marked the flotation and management of British railways in those early days were gradually corrected by the criticisms of a few honest and competent journals.

Morier Evans, the historian of the crisis of 1847–48, compared the prices of certain railway securities in the height of the boom (August 1845) and the depth of the depression (October 1848). Thus in August 1845, Great Western rose to 236, and fell in October 1848 to 65½; London and North-Western rose to 254 and fell to 99; Midland rose to 183 and fell to 64. Northern of France rose to 7⅜ and fell to 5⅜. Scandals of all kinds surrounded the promotion of our railways. Extortionate sums were paid for worthless land. The financiers, the lawyers and all concerned had such pickings and perquisites that we can hardly understand (even after allowing for the good work of the critics) how the main English lines emerged with their finances on a basis so much sounder than similar undertakings in many other countries.

Capital was collected from all parts of the country, and the transactions in railway shares were so voluminous and universal that the ordinary channels were quite inadequate. Clerks at small salaries in banks and merchants' counting-houses openly proclaimed themselves buyers and sellers of the various favourite shares, just as if they represented their employers. Not only in London, but in Manchester, Leeds, Liverpool, Glasgow, Dublin, Hull, Edinburgh and Bristol, railway share markets were established, and the business of the City was for a time equalled if not surpassed by the

provinces. As an anxious contemporary put it on the eve of the crisis: 'The farmer is now as deep in railway shares as the merchant, the merchant as the banker; and the whole circle of society is entangled in the mania.'

We have here in miniature what happened to Wall Street and the United States in 1929. The long list of failures that occurred in 1847 and 1848 resembled American experiences in 1930 and 1931. But with every succeeding decade the stability of British banks and merchant houses and of all our financial institutions grew steadily with the increasing wealth and intelligence of the nation. In the pages of Bagehot, and other writers, we may read of a strain on credit which caused extraordinary measures to be taken by the Bank of England in 1857 as a result of the American panic, and again in 1866, after the failure of Overend Gurney.

The Baring Crisis of 1890 was brought about by over-confidence in the pace at which Argentina's potential wealth could be developed and exploited. In the two previous years over 60 millions of British capital had been lent to Argentina, but in midsummer 1890 a loan of 5 millions for the Argentine Government missed fire. A revolution and a run on the banks followed. Mr. Burn says: 'The fall in South American securities was very heavy, and the situation from August to October was very delicate. There was a decided undercurrent of opinion that several houses, notably Baring's, had dangerously increased their acceptances.' At the weekly meeting, on Thursday, 6 November, of the Directors of the Bank of England the Bank rate was unaltered,

though the reserves stood at only 11 millions; but on the following day it was unexpectedly raised to 6 per cent., and the Stock Exchange began to be alarmed. However, the settlement on the following Tuesday passed off without trouble. But on the Wednesday three banks were reported to be in difficulties. On Thursday it was learned that the Bank of France had lent 3 millions of gold to the Bank of England; on Friday a meeting was held at the Bank to consider the affairs of Messrs. Barings, and on Saturday (15 November) it was definitely announced that a scheme had been carried through to enable them to meet their liabilities. The firm's liabilities, which amounted to 21 millions sterling, were liquidated in the course of four years; but the effects of this suppressed crisis remained for a long time.

A speculative recovery was powerfully stimulated by the wonderful discoveries and skilful exploitation of the Rand mines in the Transvaal by cosmopolitan groups of financiers, among whom Cecil Rhodes was the most popular figure. This Napoleon of Cape Town and Kimberley became the hero of our Stock Exchange. Skilfully blending finance and politics, he for a long time worked in alliance with the Dutch party at the Cape, keeping on good terms with the Boers, and simultaneously by a handsome contribution to Parnell's funds he contrived to secure Irish Nationalist assistance for the Chartered Company. Nevertheless his reputation in London was that of an empire-builder. The Press fell under his sway, and the London Stock Exchange responded enthusiastically to all the

financial schemes, good, bad and indifferent, of the new South African leader and his fellow-magnates. But the enormous fortunes made in the 'nineties under the Kruger regime did not satisfy the millionaires of the Rand and Park Lane. Those who had received much wanted more. Those who had shorn one flock of investing lambs wanted to shear another. The cosmopolitans of Johannesburg styled themselves reformers and conceived the idea of turning out the Boers and of so producing another Kaffir boom which would raise their wealth beyond the dreams of human avarice. In pursuance of this plan fictions of all sorts were circulated. Old President Kruger, obstinate and unenlightened, but a quite human mixture of shrewdness and stupidity, virtue and vice, was represented as a monster of tyranny and corruption. The strength and courage of the Boer farmers were made light of, and Rhodes even assured the British Government (then embarked on a policy of interference) that the Boers could not shoot. It may be doubtful how far the Cabinet really meant to go, and how far it drifted into an avoidable catastrophe through mere mishandling of the negotiations. But, whether deliberate or accidental, certain it is that the war proved more disastrous to the London Stock Exchange and the interests of the City than any event which had taken place since the failure of Overend Gurney. A military promenade, which was to have been over in a month or two, resulted in three years of stubborn and anxious warfare. The total cost, which was estimated by Sir Michael Hicks-Beach, the Chancellor of the Exchequer, in

October 1899, at 10 millions, to be defrayed by a levy on the gold mines, eventually came to about 250 millions, every penny of which was contributed by British loans and British taxes. For a moment, at the outbreak of the war, Transvaal mining shares rose, but as soon as the idea of a promenade vanished, and a long prospect of difficult and costly operations opened out, they began to droop, and fell to lower and lower depths as the war dragged on. British $2\frac{1}{2}$ per cent. Consols had receded partly as a result of increasing expenditure and diminishing Sinking Fund, partly through fear of war, from a top price of 113 in 1898 to about 104 at the outbreak of hostilities. But the 'Khaki' $2\frac{3}{4}$ per cent. loan in the spring of 1900 was raised with enthusiasm, showing that the public believed in a speedy ending of the war and a substantial indemnity from the mines. When the Milner policy of unconditional surrender was at last abandoned, and the peace of Vereeniging signed, Consols and Kaffirs rallied. But it was only a short and feverish flicker of speculative purchases, which collapsed under heavy liquidation. The mining industry had been temporarily ruined, the cost of living had risen, the native labour had dispersed, a strange mixture of luxury, waste, misery, disease, plunder and demoralization had dislocated the social organism and the mechanism of business. Many of the promoters and speculators who had been most eager for the war were ruined. All the mining houses connected with the Rand suffered severely, nor did they recoup their losses by the costly experiment of importing Chinese coolies.

A declension of Consols by 20 per cent. was proportionate to the increase of supply; for the National Debt was enlarged by 160 millions sterling in order to meet the extraordinary expenditure on the war. For four or five years the Sinking Fund was practically or actually suspended, and when, under the firm financial guidance of Asquith, the reduction of Debt was vigorously renewed at an unparalleled rate, the decline of national credit was checked rather than arrested; for the Russo-Japanese War had drained many millions of British and French capital into the new 5 and 6 per cent. bonds of these two combatants. In fact the public debts and securities of the world, along with wars, armaments and taxation, had expanded in the first thirteen years of the twentieth century faster than the effective demand for them. For Consols to yield more than 3 per cent. in time of peace and prosperous trade seemed then abnormal. The annual average price of the world's premier security declined pretty steadily from about 111 in 1898 to 88 in 1904, 79 in 1911 and 73 in 1913. In 1920 Consols averaged only 47. In the next three years they recovered ten points. During the credit and exchange crisis of August 1931 they were round about 57. It should be remembered that the scope of trustee securities had been extended by some 300 millions in 1900 for the benefit of our colonies, and the growth of armaments in the years preceding 1914 represented an annual economic waste equivalent to what our grandfathers would have considered a very formidable and costly war. Then came the Great War which multiplied the

National Debt by twelve, raising it from 650 millions on 31 March 1914 to 7,829 millions at the same date in 1920. Between these years the annual charge for interest and Sinking Fund rose from 24 to 350 millions.[1]

The effect of the Kaffir boom in England was to create a new and very popular field for speculative investment. The House rapidly expanded, and the mining section suddenly bulged out into the Kaffir Circus, which after hours filled Throgmorton Street with wild and noisy confusion. The slump was disastrous and protracted. The losses in Chartered shares and in many of the inferior mines of the Transvaal and of Rhodesia were never recovered, but the intrinsic merits of the Rand mines, the reconciliation and union of South Africa, the appreciation of gold since 1924, and a great improvement in the labour supply have helped to restore values to the Kaffir market. Nevertheless, gilt-edged stocks of all kinds, home, colonial and foreign, British railways, and many industrial securities have undergone, as the direct or indirect consequence first of the Boer War and since then of the Great War, enormous losses. In many cases investors have seen the whole (as in Russian bonds) or nearly the whole of their capital disappear. The loss of capital and credit caused by such a shrinkage cannot be computed; but every banker and cambist in London knows how much London's prestige and influence as the headquarters of international

[1] In 1946 it had mounted to 490 millions, and the total of the internal dead weight debt was 23,000 millions at the time of the Budget.

money and exchange were shaken. If those who entered on these wars had also imposed a high tariff on imports, the greatest emporium, the greatest shipping, broking and banking centre of the world would have been not only shaken but shattered. Grass would have grown in the Port of London and in the streets of the City. Gradually the London docks and warehouses would have emptied, the sterling bill on London would have lost its value, the London money market and the London stock markets would by degrees have yielded their proud supremacy — a supremacy founded upon a wise policy of political, economic, commercial and financial freedom. Thanks however to its comparative immunity from tariffs (till 1932) and the consequent importance of its wholesale markets, London by 1929 had regained to a large extent its position in international finance and trade, and is still a great mart for food, metals and raw materials of all kinds. Owing partly to this, partly to its then vast supply of free and loanable capital, it acquired before the catastrophe of 1914 a highly profitable command of the expanding market in rubber. With this control of the raw product, which was long governed by the sales in Mincing Lane, the acquisition and financial management of the new plantations for the growth of 'tame' rubber came naturally to Great Britain. The rubber boom in the spring of 1910 might fairly be represented as the harvest which English and Scottish financiers and brokers reaped as a result of free markets and unimpeded trade. After the War rubber prices

collapsed, and the Stevenson restriction scheme was introduced into the Malay States and Ceylon. For a time it was successful; but its effect was to stimulate the rubber output in the Dutch Indies, and being (like other restrictive schemes) unsound, it was dropped. From that time until the present (1931) rubber plantation shares have fallen lower and lower with the price of rubber, which has recently sunk below twopence-halfpenny per pound. Before the War of 1914 it was never less than half a crown.

It remains to say a few words as to the rules of the London Stock Exchange and its methods of doing business. The feature which distinguishes it from provincial, colonial and foreign Exchanges is the division of functions between brokers and jobbers, a division which seems to go back to its foundations. The jobber works on the floor of the House, and deals only with the broker. The broker takes orders from the outside public and buys from or sells to the jobber. Thus the broker feeds the jobber much as the solicitor feeds the barrister. The broker takes his commission and the jobber his turn. The working of the system may be illustrated by a simple example. Jones, an investor, sees that the old 2½ per cent. Consols stand at about 59.[1] He determines to buy £1,000 nominal, i.e. to spend £590. So he tells his broker Smith to buy him that amount at the best price obtainable. Smith goes from his broker's office into the House and makes his way to the group of jobbers

[1] In 1946 the price is higher but the yield has been reduced by income tax.

who deal in the Consol market. He finds Robinson and asks him the price of Consols. Robinson replies $58\frac{3}{4}$–59, meaning that he will buy at $58\frac{3}{4}$ and sell at 59. Smith buys from him at 59, and the bargain is complete. Smith sends a contract note to Jones which runs as follows:

£1,000 Consols at 59	£590
Contract Stamp	2s.
Commission $\frac{3}{16}$	£1. 17s. 6d.

Jones sends a cheque for £591. 19s. 6d., which expressly includes the broker's commission, and also in reality includes the jobber's remuneration. This system, with its division of functions, is very good for active securities in which there are numerous transactions. In such cases the separate existence of jobbers makes for a free market and close prices. There is no place in the world where good stocks are more easily and quickly realizable at a minimum of loss, or purchasable so near the market price, as on the London Stock Exchange. For this and other reasons it receives a vast amount of American and foreign orders, and its official list is the largest and the most international in the world. But the investor should note that a quotation in the official list does not mean, in the case of securities seldom dealt in, that your broker can at any time get a jobber to deal in the stock at the nominal or quoted price. And when there is a slump in a market and a rush of selling orders with no support, the jobbers will quote very wide prices and the brokers have to report to their clients that they simply cannot find a purchaser at anything like the official quotations.

It has been noted that London Stock Exchange brokers are not allowed to advertise. They may only send circulars to their own clients. The first business, therefore, of an English investor is to find a good broker. He will then be protected in all his transactions by the rules and regulations of the London Stock Exchange. Or if he lives in a large provincial town with a Stock Exchange of its own, he may prefer to do business with one of its members—a local broker. In that case he will probably be just as well served.

When the Great War broke out in the late summer of 1914, international finance was immediately thrown out of gear. All was chaos by sea and land. Commerce between great nations was suspended. Bourses were closed. All the belligerents stopped payments in gold, and issued inconvertible paper currencies. Huge war loans were floated; inflation began everywhere, and prices even in England rose and rose until they had trebled. On 30 July 1914 the London Stock Exchange was closed as a precautionary measure, and was only reopened on 4 January 1915, under emergency regulations, which prohibited speculative operations and provided that all transactions must be for immediate settlement. When full facilities for Bulls and Bears were at last restored in 1922, four years after the peace, an exception was made in the Consol market where cash dealings were continued.

Early in September 1931 the London Stock Exchange resumed its pre-war practice of meeting on Saturday morning; but after the suspension of

the gold standard on Monday, 21 September, it was closed for two days and on its reopening, temporary restrictions on speculation were imposed.[1]

[1] For later history see the last chapter.

CHAPTER III

LONDON'S FOREIGN BOND MARKET AND THE FOREIGN BOURSES [1]

A SPECIAL chapter will be assigned to Wall Street and the American market, which stand apart from other foreign markets and bourses, though, since the War of 1914, American isolation has come to an end, and the United States is now deeply involved in the financial affairs of Europe and South America. But London's financial relations with the world in general are very different from its relations with America, and this distinction is accurately reflected by the London Stock Exchange.

The causes that have attracted foreign merchants and speculators to London from the time of the Romans well deserve detailed examination. The economic historian might show how admirably the estuary of the Thames was adapted for commerce with all the northern ports of Europe, and how, after the discovery of America, the capital of England was almost bound to be the centre of the commercial world. Our insular security and our rich resources of coal and iron enabled us to take full advantage of the inventions which revolutionized manufactures, transport, and exchange between 1750 and 1850. British shipping and British

[1] This survey ends in 1931. Since the second Great War we have ceased to be a creditor nation, and most of our foreign bonds are in default.

manufactures, though small in comparison with modern ideas, were large in comparison with their rivals. In capital, credit, currency, and the art of banking, London got the start and kept it. Necessitous foreign governments and corporations began to look to London houses, like those of Rothschild and Baring, to supply their small, but growing, demands for capital. Eighty years ago, indeed, Paris was still a formidable rival in finance, and the United States in shipping. But just at this critical moment England adopted the policy of a free market for gold and all commodities. A sound currency and a superior banking system were firmly established at the same time that perfect freedom of importing and exporting was given to the whole nation. In the course of a few years all protective duties, and all duties upon exports such as coal and machinery, were entirely removed. Our trade advanced by leaps and bounds in the prosperous period of Gladstonian finance. British shipping expanded at such a rate that before the end of the nineteenth century it represented, roughly, half the world's mercantile marine. The United States, after the Civil War, adopted an exactly opposite policy of restriction. Prices were artificially raised. The high tariff wall, which was erected to exclude foreign competition, raised the cost of production. American manufacturers were unable to compete in neutral markets, and the American mercantile marine, which had threatened to rival and outdistance ours, dwindled into insignificance. Meanwhile, on the Continent, Germany forged ahead under the stimulus of the

Zollverein, which swept away all the petty tariffs that had isolated and impoverished its kingdoms and duchies. A fairly liberal policy, aided by the adoption of a gold standard, allowed German commerce to grow rapidly, and London benefited enormously by the increasing wealth of Hamburg and Berlin. France clung to the bimetallic system, which prevented her great stores of gold and capital from playing their full part in international operations. Even after 1928, instead of employing the gold standard intelligently, she hoarded the precious metal to the detriment of international trade and credit.

In Bagehot's *Lombard Street* the retrospective eye may see how London had become, in the 'seventies, the great centre for the investment of capital and for the diffusion of credit. With the suspension of specie payments by the Bank of France during the Franco-German War, its use as a reservoir of specie came to an end. 'No one can draw a cheque on it and be sure of getting gold or silver for that cheque. Accordingly, the whole liability for such international payments in cash is thrown on the Bank of England.' Eight years after Bagehot wrote these words — in 1878 — the Bank of France resumed specie payments. But it could not recover its position as a European settling house. Before the War of 1914, the stocks of gold at Paris and Berlin were not accessible, because the Bank of France could exercise an option to pay in silver at the old conventional ratio, and the Bank of Germany could practically prevent gold payments whenever they appeared inconvenient. Thus, by a concurrence

of natural and fortuitous circumstances with the restrictive and artificial regulations imposed by potential rivals, the number of international bills drawn on London incalculably surpassed, and still surpasses, those drawn upon other centres. It remained until 1914 the greatest shop, the greatest store, the freest market for commodities, gold and securities, the greatest disposer of capital, the greatest dispenser of credit, but above and beyond, as well as by reason of all these marks of financial and commercial supremacy, it was the world's clearing house. The wealth which it thus acquired and disposed of was vaster far than in the days of Bagehot, when the London Money Market was usually dependent on the Bank of England. Before the War of 1914, in normal times, it could finance itself. In Bagehot's time the output of capital issues or loans to British, foreign, and colonial borrowers would vary from twenty to thirty millions a year. In 1910 the figure went far above 200 millions.[1] A single illustration may be given of London's banking power in pre-war days.

In 1908, after the great American panic, the United States Government appointed a Commission to suggest monetary and banking reforms. The Commissioners came over to Europe and made close inquiries. Their interviews with leading bankers in London, Paris and Berlin, which were

[1] Since the War our surplus savings and capital exports have been lower than in pre-war years, when allowance is made for the change in the purchasing power of sterling. Nevertheless the total capital issues of London in 1930 reached the high figure of 267 millions, of which the Colonies took 61 and foreign countries 35 millions.

afterwards published, constitute a valuable accumulation of ascertained facts and authoritative opinions.[1] At the Bank of England they learned how, in times of stress, its rate dominated and controlled all the money markets and gold-movements of the world. The crisis which broke out in New York, in October 1907, was the most formidable of its kind ever known. There had never been such an enormous demand for gold; yet the drain was successfully met, and practically all that the American banks required was supplied in a few weeks from London without any dangerous depletion of the Bank's reserve. On 31 October the total bullion held by the Bank was 31 millions, and the Bank rate was raised to 5½ per cent. On 4 November it was raised to 6 per cent., and on 7 November to 7 per cent., the total bullion held being 28 millions. This rate proved effective, and from that time the inflow of gold from abroad exceeded the outflow to New York, so that on 11 December the total bullion was 34 millions. Gold came to London from twenty-four countries, including British colonies; and by the end of January, when the rate had been gradually reduced to 4 per cent., the Bank of England's stock of gold had risen to 38 millions sterling.

With this supremacy as bullion broker and arbiter of credit, as disposer of cash for short

[1] This commission supplied a scientific foundation upon which the Federal Reserve System was afterwards built. It was under the direction of the late Senator Aldrich. I saw a good deal of him both in London and Washington; and contributed to his publications an essay on the Credit of Nations.

periods and lender of capital to foreign and colonial borrowers, it is no wonder that London through its Stock Exchange has long provided the world's principal market in foreign securities. Hardly a country can be named 'from China to Peru' whose bonds are not dealt in almost daily by the leading jobbers. For that reason, among others, the deep depression of trade and the collapse of credit all over the world in 1931 caused heavy losses to London, and drove Britain off the gold standard. The German moratorium hit London, and so did the defaults in Chile and other countries.[1]

Before the War of 1914 the taste of the British public for investment abroad grew rapidly with the increasing overflow of our surplus capital. Perhaps we were a little too much inclined to trust the foreigner. Certainly there is often a want of discrimination. A bond yielding 5 to 6 per cent., with a strong power like Japan or a prosperous country behind it, may be pretty safe[2]; but for the sake of an extra 1, 2, or 3 per cent. a certain type of investor is willing to run a serious risk of losing his capital in some dishonest municipality, or discredited government, or in a company formed abroad for the very purpose of defrauding him. Many persons who read these pages may probably have received ingenious circulars suggesting that risks can be avoided by a geographical distribution of capital, and that in this way a high yield can be secured without danger. It is at first sight a

[1] Since 1939 our foreign bond market has been reduced to insignificance by defaults.

[2] So it seemed in 1931!

taking fallacy. But a single question will discover and expose it. How can four rotten companies, located, let us say, in Brazil, Costa Rica, Malaya, and Turkey, be made less rotten by the fact that they are widely separated?

Our markets for foreign bonds and foreign railway securities stand, of necessity, in close connexion with the foreign bourses on which the same or allied securities are quoted. In some cases, where the credit of a country rests almost entirely on its credit in London, the tone of the London market will dominate the tone of the domestic bourses. The distribution of British capital need not be discussed here. But it should here be plainly stated that our foreign trade and the supremacy of the London Stock Exchange in international stocks were founded in the past largely on well-directed exports of capital. Thus London held a great part of the external debt of Japan, and the price of Japanese bonds still depends largely upon London's judgement of Japan's financial strength at any given time. The internal bonds, mainly held in Japan, yielded a higher rate of interest, and stood on a more independent footing. Again, the great Argentine railways were British companies, with their head offices in London, so that London was the principal market for their bonds and shares until 1948. The external debt of the Argentine Government was also held mainly in London, until the great wars. Most of it had in fact been issued at various times by Barings and other London houses.

British investments in Argentina—Government

debt, railways, land companies, ranches, etc.—ran to several hundred millions sterling. Smaller, but still important, have been our holdings (sadly depreciated) in Brazil, Chile, Peru, and Mexico. The London house of Rothschild is the agent and guardian of Brazilian finance, a delicate and difficult task. The instability of the Latin republics of South America is proverbial. Upon the whole, the Governments of Argentina and Brazil have usually enjoyed the best credit,[1] but the security of a good Argentine or Brazilian railroad is often preferred to that of the Government, and is certainly superior to the credit of municipal or provincial securities, among which there have been many defaulters. It is hardly possible to speak of 'investment' in Central America. Any one who buys the paper of those States is a mere speculator. Bankruptcy and repudiation are the rule, payment of interest the exception. Even in South America, a public authority which has not within the past seventy years repudiated its debt, or compounded with its creditors, is a rare exception. No doubt, as civilization advances and trade expands, South America should gradually become a safer and safer field for the investment of savings. But the utmost care ought to be exercised, especially when seductive offers of (unmarketable) bonds are received through the post. It is essential that the security should be quoted on the London Stock Exchange, but even then the price quoted may be an old one at which it is easy to buy, but

[1] Chile, after a long record of solvency, defaulted on its foreign debt in the summer of 1931.

impossible to sell. The amateur investor should make a selection, and then consult a good broker on the London Stock Exchange as to present prices and prospects.

Of European bonds it is difficult to write now (1931) with any sort of scientific certainty. All the continental belligerents and the new states which have come into being in Eastern and South-eastern Europe are overloaded with taxes, tariffs and war debts, or shorn of credit and liquid capital by currency depreciation. But hitherto interest on the sterling loans of Germany and its states and municipalities, as well as the League of Nations loans contracted since the War, has been duly paid. The public loans of small countries which remained neutral—notably Holland, Switzerland, Sweden and Denmark—are considered as gilt-edged securities.

After the London Stock Exchange that of Paris stands next as an international factor, because, after London and New York, Paris has the greatest amount of disposable capital both in the short and the long loan market.[1] The annual overflow of British savings into foreign and colonial investments before the War of 1914 averaged about 200 millions sterling; the average overflow of French savings was perhaps a quarter of that sum. For its size, Holland contributed, and still contributes, freely, but Germany required most of her savings for home investment, and is now (1931) a needy

[1] Wall Street has also developed an important market in foreign bonds owing to a great output of dollar issues to European and South American states after the War of 1914.

and greedy borrower at high rates of interest from distrustful creditors.

The French divide their bourses into two kinds —commercial exchanges (*bourses de commerce*) and stock exchanges (*bourses des valeurs*). Their history goes back to medieval times, but the clearly-marked division between the two is comparatively modern. The merchandise brokers, who operate on the commercial exchanges, are called *courtiers en marchandises*. The operators on stock exchanges are called *agents de change*. Under the old regime both professions were monopolized, and both were thrown open after the Revolution. The merchandise brokers are still free, but after various changes the French stockbroker is now again a privileged person with exclusive rights, not only to trade in government and other officially quoted securities, but also to negotiate bills of exchange and similar instruments of credit. The stockbrokers of Paris number only seventy, and form a close corporation under Government control. The provincial bourses, of which Lyons, Bordeaux, Marseilles, Lille, and Nantes are the most important, are very similarly organized.

According to M. Vidal, the author of a brilliant study on this subject, the monopoly of stockbrokers and the privileges of the Paris Bourse rest upon legislation of 1807 and 1816. A stockbroker really owns an office under Government, which holds from him a bond, on which he receives interest. When he withdraws from business he has a right to sell his office and transfer the bond to a successor whom he introduces to the Government.

Year by year this monopoly of the stockbroker increases in value as business and commissions multiply. But the Government occasionally modifies conditions, as in 1898, when it increased the number of Paris stockbrokers from 60 to 70. At first, the Paris Bourse was forbidden to quote foreign securities, but this prohibition was removed in 1823. But many securities are not quoted in the official list of the Paris Bourse, either because the stockbrokers (possibly under Government inspiration) have not chosen to admit them, or because they do not fulfil statutory conditions. Such securities, however, may be, and often are, dealt in on the coulisse, which may be described as the curb market, so called because in former times the bankers and coulissiers thronged a narrow passage called *La Coulisse.* Anybody may become a coulissier, or outside broker, who likes to pay the licence duty. And while dealings in French *rentes* are by law restricted to the stockbrokers who deal on the parquet, a market in these exists and is tolerated on the coulisse, though the transactions of coulissiers in these securities are not recognized by courts of law.

Among foreign bourses, from this international standpoint of the foreign market, Paris stood easily first up to 1914 in power and resources. The capital exports of France had long been on a substantial scale, and consequently its holdings of foreign securities were very large. Before the War it was *the* great market for Russian bonds; it held most of the Spanish, Portuguese and Turkish debt, and had considerable amounts of capital invested

in Egypt, Tunis, Roumania, Greece, Mexico and South America.

Probably more than half the French pre-war investments have been lost, and the French people have also been deprived by currency depreciation of four-fifths of the sums they lent to their own Government in *rentes*.[1] No wonder that this thrifty nation is now inclined to hoard rather than to lend. Before the War it was estimated that in normal years the French people put aside in savings about £70,000,000, of which a variable fraction went abroad. This seemed small compared with British capital investments (amounting in 1910 to 250 millions sterling), which, of course, represented only a portion of our national savings; but it was a very large sum compared with other countries. Germany's wealth was then probably increasing more rapidly than that of France, but its annual surplus was mostly absorbed by the requirements of the Imperial and State governments and of the municipalities, whose debts had been increasing at a prodigious rate, as well as by the demands of a world-wide trade which was largely carried on credit. Hence the great Stock Exchanges of Germany—Berlin, Hamburg and Frankfurt—were, and are, almost entirely concerned with national, state and municipal loans, with German bank-shares and German 'industrials'. The Berlin Bourse consists of two departments,

[1] The old French gold franc was worth about tenpence: the new 'stabilized' franc was worth about twopence in gold sterling in 1931. In 1946 it was worth less than a farthing in paper sterling.

the Stock Exchange and the Produce Exchange, and both are supervised by the Chamber of Commerce. Its members are highly speculative and this spirit has been encouraged by leading bankers—with disastrous results in the summer of 1931 when a moratorium was declared and the Berlin Bourse was closed for several weeks. The stock exchanges of Frankfurt and Hamburg are also of more than local importance though they have suffered much in consequence of the War. Big German loans are usually issued simultaneously by a 'consortium' of banking houses in all the chief cities of the Reich.

The Dutch people are very active speculators, particularly in oil companies and in some American railroad and industrial securities. The importance of the Amsterdam discount market has grown at the expense of London since 1914. The Amsterdam Bourse is in close communication with the London Stock Exchange. The Brussels Bourse looks to both Paris and London. Its speciality used to be tramway companies, of which it was the pioneer. At Antwerp—a great port and emporium—speculation is busy with raw products such as wool, rubber and coffee.

Before the War of 1914, thanks to its high tariff, the manufactures, commerce and navigation of Tsarist Russia were controlled by monopolies and combinations, which capitalized the tariff in much the same way as the more celebrated 'Trusts' of the United States. The largest of these, 'Prodameta' (from 'prodet', to sell, and metal), had with its subsidiaries a capital of £18,000,000. There

were similar combinations in coal, petroleum and navigation. Thus the ground was prepared for the Soviet system of State monopolies just as the police and spy system of Imperial Russia has been reproduced by Communist Russia.

Even before the Soviet revolution, when private property still existed, and the rouble possessed a stable value, the Russian public had too little cash and too little enterprise to drive a great business in stocks and shares. Here, as elsewhere, the Russian Government's repressive policy made itself felt. The 'Birsha' of St. Petersburg was prohibited from dealing in non-Russian securities, and even the Russian banks were debarred from advancing money on foreign securities. Jews and foreigners were prohibited from lending money on mortgage, with the result that first mortgages in Russia could only be placed at 8 or 9 per cent. interest—then a usurious rate.

The St. Petersburg Bourse was much smaller than the stock exchanges of Glasgow, Manchester, or Liverpool, in so far as it had only 56 authorized brokers. But any person introduced by a broker or banker might do business in the Birsha on payment of a half-yearly subscription, and a stranger could even be introduced for the day for a fee of one rouble. There was, therefore, a strange mixture of free trade and monopoly. The official list of the St. Petersburg Bourse contained about 500 securities, all Russian, the chief activity being in the shares of railways and banks. There was no business for the account and no regular settlements. In Soviet Russia foreign debts and property were

confiscated, and as there was no free financial intercourse, and no stable money, there was no room for stock exchanges or money markets.

The two principal bourses of Spain are in Madrid and Barcelona, and Madrid is the more important. Spanish banking and finance are still (in 1931) largely under French control. But Spanish capital is growing, and the people are beginning to own a large and ever larger share of the public debt. British capital is mainly interested in mining and commercial enterprise, especially at Bilbao, Barcelona, Seville, and Juarez. In spite of colonial wars and increasing armaments Spain and Italy made remarkable progress in the first thirteen years of this century, and the advance of their financial credit was all the more extraordinary by contrast with the general downward movement in gilt-edged stocks as well as in the best railway debentures during that period.

Before joining the Allies in the War of 1914–18 the Italians had bought up their debt (chiefly held in France) with amazing rapidity, and seemed to be in a fair way to revive their medieval prowess in international finance. The chief bourses of Italy are in Rome, Turin, Genoa and Milan. An economic and Stock Exchange crisis occurred in 1899–1900, and again in 1907–8. Between those dates Stock Exchange values expanded, and the period of prosperity terminated in a great outburst of speculation. The boom began in January 1905, and culminated for a time in September. Then came a set-back, but another rapid expansion followed, which terminated in March 1906. The

most popular mania was for motor-car company shares. The 25-lire shares of one company (the Fiat) were actually bought up to 2,300 lire—92 times the nominal price of issue. The company then subdivided its shares. In November 1906 the new 10-lire shares stood at 750. By October 1907 they had fallen to 80 lire, and by May 1908 to 34 lire. Turin was the principal market, and the speculative mania produced even more ridiculous excesses than the rubber share mania in England. What remained of the bubble was pricked in the autumn of 1907, by a sudden cessation of purchasing from the United States, when luxurious expenditure of all kinds was curtailed after the fall of the Knickerbocker Trust. The War of 1914 increased the size and diminished the wealth of Italy. The Stock Exchange securities of Italy (1931) consist, first, of the national debt, including the nationalized railways, second banks, third mines, fourth electrical companies, and, lastly, industrial companies of all kinds, representing a more or less watery capitalization of the protective tariff.

More interesting to British investors than either Spain or Italy are the two great rival powers of the Far East, Japan and China. The rise of Japan, by a rapid adoption of Western methods, to the position of a strong military and naval power (culminating in its defeat first of China, and then of Russia) was, of course, coincident with the creation of a heavy debt and onerous taxation. As Russia leaned upon Paris, so for their war with Russia the Japanese turned to London, where they contracted large loans mostly at 5 per cent. After

the conclusion of peace they succeeded in keeping their expenditure within their income, and by very skilful finance gradually converted most of their debt to a 4½ per cent. basis. The same speculative fever and spirit of commercial expansion, which pervaded Europe and America in 1906 and 1907, invaded Japan. The stock exchanges of Tokio and other large towns were scenes of great excitement, and when the American crash came, in 1929, no country was more utterly prostrated than Japan, dependent as it was on the United States market for its silk and other exports. A great many failures ensued. Banks closed their doors, and some German houses, which had introduced a system of long credits, came to grief. Similar consequences followed the Wall Street slump of 1929. But in the meantime Japan had made great strides in shipping, commerce and manufactures. Its cotton trade especially had expanded during and after the War at the expense of Lancashire, and its textiles are now (1931) predominant in the trade of the Far East. It has gained a large share of the trade with India.

After the suspension of borrowing by the Japanese Government, the attention of English investors in the Far East was directed mainly towards China, India, and the Malay States. The revolution in China produced civil war and political chaos; and though it did not altogether stop progress, it endangered the security of foreign investments. Against the ability of Chinese merchants and the industry of a vast population have to be placed the incapacity and corruption of the Government.

Even before the second Great War there was grave danger that funds subscribed to the Government for railway loans would be misused or devoted to other purposes. But, after all, few countries can boast that they have been free from railway scandals, and there are grounds for thinking that political reforms and a peaceful settlement may ere long renovate the whole machinery of Chinese administration. But until the mysterious riddle of China has been further unravelled, the investor in Chinese loans must regard himself as something of a speculator who deserves a high interest in return for his risk. The Chinaman is not only a shrewd and competent business man: he is also a confirmed and incurable gambler. From time to time the Shanghai Stock Exchange has been a scene of the wildest speculation, and it is safe to predict that, when a new China is evolved, stock exchanges will spring up in all the large towns, and China will become subject to vicissitudes and crises as violent as those which convulse the United States. Of this, a foretaste was afforded in the spring and summer of 1910, when Shanghai caught the rubber infection from London. All classes and races took part, but the native Chinaman plunged deepest. When the break in prices came, one Chinese operator was so heavily involved that, on his failure, many of the native banks had to suspend payment, with the result that for months the trade and credit of this great shipping and business centre were disorganized.

CHAPTER IV

WALL STREET

A FAR-SIGHTED and experienced operator, who had lately retired from the New York Stock Exchange, once encouraged me to attempt a brief sketch of the American system (centred in New York) from the standpoint both of an investor and of a speculator. On the other side of the Atlantic, indeed, an adventurous element enters almost invariably into nearly all investments, and Wall Street is a synonym for speculation. The Marble Stock Exchange of New York stands in Broad Street. But the great banks are in Wall Street. Wall Street is the nerve-centre of the richest and most speculative country in the world. It stands —in the popular mind—for all that is sinister in American politics, all that is reprehensible in American business, all that is vast and hazardous, all that is covetous and unscrupulous in high or low finance. It is a term that covers a multitude of things and provokes a multitude of thoughts in every true American. For Wall Street is the accepted mirror and barometer of all American business. There, as in a magnified Monte Carlo, fortunes are won and lost, if not by the hour or the day, at least by the week or the month. There, too, the great trusts are organized; there receiverships and profitable reconstructions are arranged; there sensational dividends and

other surprises are hatched, by the insiders for the outsiders; there melons are cut; there all things and most persons are 'done' in a strictly financial sense. But the secret of Wall Street's supremacy lies in the power of its banks as manufactories and curtailers of credit. In virtue of that power, once irresponsible, but now subject to the salutary authority of the Federal Reserve Board, it is not merely a market of bonds and shares, not merely a recorder but often a manipulator and controller of prices. One feature of Wall Street that used to strike the most casual visitor is its purely American character. Until President Wilson joined in the war against Germany it took no interest whatever in European securities. It only cared for Europe because Europe took an interest in American securities. During the first part of the War—from 1914 to 1917—American bankers and manufacturers made prodigious profits; and after joining in the War, the United States went on lending munitions and supplies to its exhausted Allies. Hence it emerged from the War as a creditor nation with large interests in Europe.

Just as our Wall Brook marks the line of the old Roman wall of Londinium, so Wall Street marks the old Dutch wall of the little Dutch Colony of New Amsterdam; but its financial story goes back hardly more than a century. In 1790, the year after the adoption of the Constitution, Hamilton reported to Congress the plan of a national bank. In 1791, despite opposition from Madison, Jefferson and other powerful men (who held a central bank to be unconstitutional, because the individual

States had not delegated banking authority to Congress), the bill was passed and signed by Washington. The Bank, which was located in Wall Street, was modelled on the Bank of England. Its charter, limited to twenty years, expired in 1811, and was not renewed. The dissolution of the Bank not only deprived the country of a large foreign capital, which could ill be spared, but was one of the causes that led in 1814 to the suspension of specie payments in most of the States of New England. The second Bank of the United States, which lasted from 1816 to 1832, was established in Philadelphia. But the financial prerogative of New York may fairly be dated from the year 1791, when it became for a time the depository of the funds of the United States Government and the seat of its financial operations.

Faint echoes of Wall Street's early days were still heard in 1880. In a gossipy chronicle of that year we read:

The names of the old merchants who went down to the sea in ships, and of the money-changers and high treasurers who, in those days, were wont to come into the Street to draw from or deposit in the United States Bank, the Manhattan Company, or the Bank of New York, to inquire for the quotations, or to exchange views on the state of the market, are almost forgotten. But, moving about among these phantom groups, we recognize the stateliest figure of all, that of Alexander Hamilton. Then we see new banks set up and operations slowly widening through the terms of five Presidents. But it is only within the past forty-five years that *Wall Street* has got a special significance as the centre, not

only of money but of speculation. From 1835 to 1880 a series of great inflations and correspondent depressions occurring there furnish a most protracted, singular and striking chapter in the annals of finance.

We may now add that the fifty years which have passed since 1880 have been even more striking and remarkable.

The early history of public finance in the United States was sadly marred by dishonesty, and this dishonesty may probably be traced to the bad traditions of currency that came from the colonial days. The debasement of a paper currency was a favourite device for reducing foreign debts, and new issues of paper were often made when a colony was in need of money. These ruinous expedients not only debased public credit and public money, they also undermined confidence and lowered the character of banking and mercantile transactions. The establishment of the Federal Union and of the United States Bank led to an improvement; but from time to time suspension of payments occurred, individual states repudiated their debts, and vicious currency legislation caused widespread loss, distrust and confusion, by which insiders with knowledge grew rich at the expense of the community. Possibly, indeed probably, the speculative temper of the American people was fostered by the ups and downs of its currency; certainly many of the worst financial crises may be traced directly or indirectly to unsound money and the insecure basis of credit. But, besides this, the rarefied air of New York acts like champagne upon a nervous and excitable population.

The association known as the New York Stock Exchange was formed at the beginning of the nineteenth century by a baker's dozen of stock-dealers, who met under a sycamore-tree in Wall Street, opposite to the present banking house of Brown Brothers & Co., and would job off small lots of 'governments', or stock in the Manhattan Company and Bank of New York. In 1816 there was a permanent organization of 28 members, and in 1837—when Rothschild's agents in New York, the big firm of Josephs, fell with a crash—the New York Stock Exchange had become a power and a danger to a community which was rapidly developing a thirst for stock and share speculation. But in the year 1862 there sprang up a formidable competitor called at first the Public Board and later the Open Board of Brokers. This was the time of the Civil War. The printing presses of the North were issuing greenbacks by the million. Ruined merchants turned in despair to speculation, and flocked to the 'coal hole', as the subterranean department in William Street was called, where the first sessions of this Public Board were held. According to a contemporary who witnessed these scenes, 'lawyers whose tastes were speculative rather than litigious, more than one clergyman whose pastoral labours were unremunerative, broken-down operators, merchants out of business, clerks out of situations, Jews "native and to the manner born", as well as the greenest and most unsophisticated parties from the rural districts, swelled the motley throng'. The ups and downs of the war, distorted by telegraphic manipulations,

helped the brokers and commission agents and money-changers; for rapid fluctuations in greenbacks and stocks of all kinds held together an active crowd of speculators. A sharp competition arose between the Old Board and the New. The New offered to do business at $\frac{1}{32}$ brokerage, i.e. 3 dollars and 12 cents on a hundred shares. The Old Board thereupon lowered its commission rates from $\frac{1}{4}$ per cent. to $\frac{1}{8}$ per cent., and resolved to expel any member who dealt with the rival body. Meanwhile the Wall Street soil produced of a sudden a wondrous mushroom growth of bankers and brokers. 'The basements of William, Wall and Broad Streets and of Exchange Place seemed to have been suddenly penetrated with innumerable burrows inhabited by new and singular animals —mostly rodents—gnawing at the vast cheese of speculation.' Promoters offered the usual wild-cat schemes that appear and are subscribed for in such times — gold claims in Colorado, copper franchises in Wisconsin, and so on. In such cases distance often lent enchantment to the view. Fluctuations of the currency during the war made all transactions hazardous. When greenbacks were issued it was hoped that they would circulate at par with the gold dollar. But early in 1862 a premium on gold appeared, and in July 1864 the premium touched 285, and the cash value of the paper dollar fell to its lowest point—36 cents. A gold exchange was opened in New York called the Gold Room, which at one time had between four and five hundred members. There was often wild speculation made in gold futures, and on one

celebrated Black Friday (24 September 1869) Jay Gould and others made a corner in gold which caused heavy losses to many unfortunate merchants.

Meanwhile the Open Board of Brokers flourished exceedingly, and in 1864 moved to a hall in 16 Broad Street. But after the war, when amalgamations came into favour, the two Boards and another Board for the buying and selling of Government bonds were united under the title of the New York Stock and Exchange Board, the same whose marble palace now fronts on Broad Street. In this splendid hall business is conducted in strict accordance with an elaborate constitution and by-laws. Membership is restricted, a seat can be bought only at a very high price. Infringements of rules are severely punished by fine, suspension, or expulsion.

It differs from the London Stock Exchange in various ways. There is no distinction between jobbers and brokers. All members are both or either. Hence there is only one transaction—no middleman stands between the public and the market. This distinction the New York Stock Exchange shares with all the Stock Exchanges of the Old and the New World, so far as we are aware. The jobber is a London creation, and he has not been imitated. Whether it is due to him or to some other cause, such as the banking supremacy of London, that the stock and share market of London is the freest market of its kind in the world is a question in dispute, and one that cannot easily be answered. The New York Exchange also differs from ours in the rigidity of its commission law. As

a centre of speculation New York has no rival. The publicity of its quotations is only matched by the rapidity with which they are circulated to the most distant towns of the American continent. This began with the tape machine, called 'the Ticker', an American invention which has been developed in an extraordinary way and has been adopted all over the world. The reliability of tape prices is remarkable, and any mistake is speedily corrected. The tape machine's mechanical efficiency contributes an invaluable check upon dishonest brokers. Tape machines are to be found all over the States; you see them in secluded health resorts, where an enterprising broker can cater for the adventurous instincts of the tired speculator. The same contrivance enables far-away newspapers to give their readers a complete list of New York prices on the following morning. But for these machines and their extension, aided by wireless, the volume of speculation could never have swollen to the dimensions attained in 1928 and 1929. It is difficult to see, now that the tape machine, the telephone and the wireless have been perfected, how the invention of aids and facilities to speculation can go much further. By these means the actual prices of securities and the alluring bait of incessantly fluctuating favourites are kept before a naturally speculative public all the time. With a tape machine by his side the banker, the merchant, the manufacturer can sip the sweet excitements of the Stock Exchange in his arm-chair. To watch the tape machine is the main business of some and the main pleasure of others. But for this invention

the Stock Exchange would probably be denuded of half its members and the other half would find their profits heavily reduced. The whole American public has been educated to the 'ticker'. Its services to the investor must be set against the stimulus it has given to gambling on the Stock Exchange. But when all deductions have been made—and of course an active market means a free market and closer quotations—it can hardly be admitted among the inventions that have enriched the world.

The fortnightly settlements of London would be impossible in New York, though it is almost incredible to an English broker that the day's transactions can be settled, as New York settles them, by the day.

On one record occasion before the War of 1914, the Clearing House settled and balanced transactions in about 3,200,000 shares, of an approximate value of 50 millions sterling. This test proved conclusively the perfection of New York's financial machinery for settling Stock Exchange transactions. But in 1929, all previous records were made to look small. On 24 October,

sales on the Exchange numbered 12,894,650 shares, passing the previous records of March 26th, 1929, by four million shares. The curb market also established a record with 6,337,415 shares. A turnover of more than twenty-four million dollars in the bond market was the heaviest since December 4th, 1924. The tickers were later than they had ever been before.[1]

[1] See my *Wall Street and Lombard Street*, page 24.

Brokers obtain their funds through two species of loans, called respectively 'Time' loans and 'Call' loans. Time loans are made for a specified date, Call loans are a speciality of the New York market. Brokerage houses in ordinary times carry 60 per cent. of their borrowings in Time loans and 40 per cent. in Call loans. Negotiations for time money are carried on directly with the lenders or with street brokers they select to represent them. Call loans are negotiated on the Stock Exchange much after the manner in which stocks are bought and sold. These 'Call' loans are all made upon collateral which must have an aggregate market of at least 20 per cent. above the face value of the loan. A call loan can be terminated by either party the next day, or any day thereafter, by giving notice before one o'clock, and must be paid at once when the lender calls it. Similarly in London bankers lend out funds 'at call or short notice'.

Before noon the banks and Trust companies notify their brokers in what is called the 'money crowd' on the Stock Exchange to lend a stated amount of money. At about two-thirty in the afternoon this crowd is thickest and noisest. By then the Stock Exchange knows pretty accurately how much it will need, and its brokers go into the 'crowd' to bid for what they want, buying money from the bankers' agents at the lowest rate obtainable.

This Stock Exchange money market of New York rests upon the basis of supply and demand. Occasional attempts are made to manipulate it, but generally without result. In the early spring of

1929, when the whole American nation seemed to be buying shares on margin with money borrowed from the banks, call money on the New York Stock Exchange rose from 12 to 15, and finally to 20 per cent., and continued at high but varying rates until the panic and the collapse in October of the same year. After that time until the present (November 1931), money rates have generally been very low, owing to depressed trade, falling prices, and an almost complete absence of speculation, either in Wall Street or in the Commodity markets.

The profession of broker on the New York Stock Exchange is a highly remunerative one, especially in periods of speculation. There are only 1,375 members. Most of them are well off and many of them are very rich. Until they have saved a sufficient capital out of their commissions they often have the good sense to avoid speculation. But when they once have money free they begin to invest and operate for their own account, or, as they say, 'take an interest in the market'. A clever man in this position, who is really in the swim and the know, can usually do well for himself; and it is surprising how many of these professionals have the self-restraint to avoid great risks. They know from the experience of unfortunate clients the danger of 'over-trading', and as over-trading is the characteristic vice of the amateur speculator a word here may be in season. 'The rapid expansion of an investor into a speculator', said a successful Wall Street broker to the writer, 'is one of our most familiar sights.' A man comes down to a broker's office with five thousand dollars, and says he wants

to invest it to the best advantage. The broker asks him whether he wishes to make a pure investment or whether he would like his holding to have 'a speculative tail' to it. In nine cases out of ten the investor admits that he had the idea of increasing his capital in mind when he came there. The broker then explains to him that he can safely buy $10,000 worth of securities, on which he can pay 50 per cent., and the broker will lend him the balance of the purchase money at current rates of interest. The broker says, in effect: 'I will buy you ten thousand dollars' worth of stock with your five thousand dollars, and with five thousand additional dollars, which I will borrow for you from month to month at 5 per cent. or whatever is the market rate, as long as you like to hold the stock.' Our investor is captivated by the plan. He neglects the possibility of a fall, in which case his losses are doubled, because his mind is taken up with the probability and practical certainty of a rise. He has opened his account in Wall Street on the basis of what is known as a 50 per cent. margin. He is half investor, half speculator. The fluctuations of the market begin to excite him. If he loses, he wants to make good the loss. If he gains, his appetite for more is whetted. He hovers about Wall Street listening eagerly for points. Presently he meets a tipster, who suggests something better and hints to the novice that he may quadruple his gains if he contents himself with a 25 per cent. margin, owning only a quarter of the stock which is to make his fortune. His own speculative investment begins to look very small and slow to him,

as he listens to the feverish and exaggerated talk all around him, and reads the inspired utterances of the secular and financial Press. The temptation to increase his risks without increasing his capital is nearly irresistible, and in a comparatively short time he has 50,000 dollars' worth of stocks with only the same original capital of 5,000 dollars, owing his broker 45,000 instead of 5,000. He is then, of course, in a position in which a small decline in prices will swamp all his capital. The investor has become a speculator, in reality a plunger. He is over-trading; the nerve strain is making him miserable, but he can't stop. A 10 per cent. decline wipes him out. No matter how good a security may be, there are many unforeseen events which may cause a fall of 10 per cent. in its market price without affecting in the least its real value. But such temporary fluctuations seldom cause, even in panics, a 50 per cent. depreciation in the value of investment securities, so that our investor would have been comparatively safe if he had not yielded to the temptations to 'over-trade'. But whether his capital is risked or not, the more he borrows and the more he shifts his securities—the greater, in fact, the cost of his holdings in interest and commissions—the more probabilities weigh against his emerging from Wall Street with a profit.

In his *Twenty Years of Inside Life in Wall Street*, Mr. Fowler related an incident of this kind which may be condensed to serve as an illustration. One day, in January 1865, a rough farmer, entering the office of a Wall Street broker, produced from his portly wallet two documents, the first a certifi-

cate of good character from the local schoolmaster, the other a certificate of $2,300 deposit in the bank of his native village. Next he spread out on the table a cutting from a newspaper headed 'Petroleum', setting forth that the books of the Sixtieth National Petroleum Company were still open to subscription; capital $1,000,000 in $10 shares, and the Company was generously allowing the public to buy them at $3 a share. The property consisted of 30 acres in the very midst of the oil region, quite near to the celebrated Buchanan farm; three wells already sunk, and room for more; every indication of oil; a dividend of 2 per cent. a month guaranteed; books to be closed positively and irrevocably on the 21st instant.

'Them air Petrollum shares is what I've come for. Two per cent. a month dividend is enough for me', said the rustic. This was at the height of the oil boom. The brokers tried hard to dissuade their client; but only by quoting the agricultural maxim, 'Don't put all your eggs in one basket', could they prevail on him to invest no more than $1,300 in this company, keeping the balance of a thousand for other tempting opportunities. They went to the office of the Petroleum Company, paid in the money, and received certificates for 433 shares. The investor was charmed with the certificates. In the foreground was engraved a flowing well, sending up a jet 100 feet into the air and falling in a graceful parabolic curve into a huge tank inscribed with the company's name. Near by was a pyramid of barrels, and in the background several vessels and railroad trains were being laden with

petroleum. The petroleum fever had raged eight months and culminated in February, after bubble companies with a nominal capital of 300 million dollars had been organized. A special Petroleum Stock Exchange had been created, which, dying soon afterwards, had its remains incorporated with the Mining Stock Board, another product of another contemporary bubble.

Five months afterwards the rustic lost faith in petroleum, and sold his stock at 10 cents a share; but he was more fortunate with his balance. First he 'sold short' in gold and made $5,000. Then he became a bull of Erie and made another $5,000; then, in spite of his brokers, he fell into the claws of the Lobster. They lost sight of him for three months until one day in November, when he rushed into the office, crying: 'The Lobster has busted, and I'm busted.'

He had just $200 left. It was a damp, chill day; every one looked blue, but the rustic's face was the bluest of all. They took him and cheered him with a certain beverage, and then found that the poor man had borrowed money from friends in his village to meet the demands of the rapacious Lobster for more margin. The debt weighed on his mind; but at this point an operator joined them in high spirits. He had just made a little pile out of a heavy fall in *Prairie du Chien*. It had already fallen to 91, and he predicted it would fall to 50 inside of the week, and volunteered to sell calls in it at 110 which should be deliverable at any time in the next thirty days. The rustic's face brightened and he gave this new friend his last $200 for a call of

200 (hundred dollar) shares. The operator filled out a form, signed it and sent it to his broker, who guaranteed it.

The document would run as follows:—

New York, November —, 1865.

For Value received the Bearer may CALL ON ME for Two Hunded Shares of the Ordinary Stock of the Prairie du Chien Company at 110 per cent. at any time in thirty days from date. The bearer is entitled to all dividends or extra dividends declared during the time.

Signed:

The stock called Prairie du Chien, or Prairie Dog, was not inconveniently large for the pool made by Stimpson and Marston in the autumn of this year (1865). There were only about 29,000 shares to be handled. In August the stock had broken to 33. The pool proceeded with the utmost secrecy to buy nearly all the stock. On the Saturday when the rustic bought his call it had risen to par. 'On the following Monday it sold from 125 to 250 in twenty minutes, amid the fiercest excitement ever known before in the Brokers' Board.'

On that 'black bear Monday', when our hero reached the lobby of the Brokers' Board, Prairie du Chien had just struck 200. Trembling with joy he fumbled forth his lucky 'call', sent it in to his broker, and in three minutes had sold his 200 shares at 210. Ten minutes later he 'called' upon his operating bear friend, who bought the stock at 225 and delivered it to the party who had just bought the 200 shares at 210. In 48 hours the two

hundred dollars had swollen to $20,000, for each of his two hundred 100-dollar shares had doubled in value between the time when he bought the call and the time when he sold it.

After this happy event the rustic might have retired to his village as an agricultural capitalist. Unfortunately, but naturally enough, history relates that he became enamoured of 'calls and puts'. He never thought of returning in glory and comfort to his village, but hunted for new opportunities in the street, until one fine day in February he heard that Henry Keep was selling calls in Old Southern at a price slightly above the market, and promptly secured calls for 500 shares duly signed by Henry Keep. Hearing of Keep's sales, and reasoning that Keep was not such a fool as to sell calls on Old Southern if it were going to rise, the bears bought his calls freely and used them as a margin to sell short. A little later, when the price had risen considerably, Keep began selling 'puts', also on favourable terms. Then the bulls bought these 'puts' and used them as margins to buy Old Southern. Thus the wily operator stiffened the price doubly, first by inducing short sales at a low price, next by inducing purchases at a high price.

A 'put', be it remembered, is in form exactly like a call; only for the key words 'CALL ON ME' you substitute 'DELIVER ME', so that while the person who buys a call does so in hope of the price rising within the time prescribed, the person who buys a 'put' does so in hope of its falling. Our hero held his call for 500 shares until Old

Southern touched 98, when he 'called', received the stock, sold it for cash at 100, and netted a profit of $12,000. Successful and elated, the farmer now blossomed out as a City man, sought the aid of a fashionable tailor and cultivated Wall Street society. A new acquaintance dazzled him with the story of the Pacific Mail. Its fluctuations from 1850 to 1864 had scattered fortune and ruin through the crowd of speculators. In December 1861, when the Trent affair threatened war with England, it had fallen to 69. The capital stock was 4 million dollars in 40,000 shares. But in 1862 a powerful ring acquired 26,000 shares, which were transferred to a banking firm to hold as trustees for five years for the joint benefit of members of the ring. After 1864, with the end of the war the price of the stock began to rise by leaps and bounds. The public demand was met with generous supplies. In 1865 the capital was increased from 4 to 10 million dollars, and the price was 240. Next year, when the capital was doubled and the price 180, the trustees of the pool held 130,000 shares. Soon afterwards L. W. Jerome, then a giant of the Stock Exchange, bought 100,000 shares from the trustees of the pool at 20 per cent. below the market price, and began to unload artfully but slowly. Unfortunately for him the winter brought currency troubles and a severe depression. The market was deluged with stock, and in a few days Pacific Mail fell from 163 to 115. In later years the watered stock of this steamship company sank to 10; but the fall to 115 pretty nearly ruined Jerome, who was only saved from extinction by the charity of

the pool, which released him from part of his contract. 'The same blow', we are told, 'which felled this financial giant also struck hard upon our bucolic pigmy.' Dazzled by the fortunes won in Pacific Mail, he had bought 400 shares at 175, putting up a margin of no less than 60 per cent., 'a dead open and shut thing' as he expressed it, certainly a judicious and ample margin in ordinary cases. But in thirty days this margin was wiped out. He sold his 400 shares at the lowest panic price, losing $24,000. For a month the agriculturist retired to the backwoods with a poor remainder of $5,000. But he returned, and by a series of lucky turns raised it in eight months to $13,000. Then he ran across his Pacific Mail adviser, who gave him another inside tip about Atlantic Mail. Unwarned by his experience with its Pacific sister, he listened to the story of its wonderful promise. It had fallen 20 per cent. and must recover. So he bought 100 shares at 93, depositing a 10 per cent. margin. That very day Atlantic Mail began to drop. It hung for a while at 87, and then broke 64 per cent. in an hour. Again our poor friend sold at the lowest point, 23. It usually happens so. After this calamity he retired finally from Wall Street with $2,500 in his wallet, just $200 more than he had brought with him originally. His first, best broker asks why he did not retire with his $30,000 safely invested, and replies—

'Operators come into the street with the intention of making 5 or 10 or 20,000 dollars, which having been done, they say they will draw out their

profits and retire. But they don't. Their broker blandly hovers over and guards their precious little piles *for himself.* He inquires in an insinuating voice, just as he is going to the Board, whether his customer "has anything to say". The customer generally has something to say in the shape of an order to buy or sell, and then in five minutes, or thereabouts, he finds his pile is locked fast as a margin in the fond embrace of his broker, who sits over it and feeds upon it till what with interest, commissions, turns, losses, etc., the precious little pile dwindles, and finally disappears.'

It hardly needs argument to prove that the odds are heavily against the amateur speculator. If he is not actually fleeced and swindled he is far more likely than not to lose. It is like betting against the bank. The wear and tear of commissions and stamps and interest eats away his capital, even if the luck is evenly balanced. As an example of the means by which the small fry find their way into the mouth of the great pike operators a very old story may be revived. Jay Gould—or some such person—on one occasion being asked for advice by the pastor of a rich and fashionable New York Tabernacle, whispered a recommendation of Pacific Mail and promised to reimburse the pious man if his purchases of that stock should result in loss. When the pastor came to him later, deeply distressed by a heavy personal loss, Gould was as good as his word, and promptly handed him a cheque for the amount. 'But how about my parishioners?' inquired the reverend gentleman. 'You placed no ban of secrecy upon me, and their

losses are enormous.' To which Gould replied calmly, 'They were the people I was after.' Thus was verified a Japanese proverb: 'The darkest place is just below the candlestick.'

Thomas Gibson, in an analysis of the art of speculation, described the results of a careful examination of 4,000 speculative accounts spread over a period of ten years. Four points were established:

1. Most of the operations were pure gambling.
2. Success almost invariably led to excess and disaster.
3. There was a marked tendency to buy at the top and sell at the bottom.
4. About 80 per cent. of the accounts showed a final loss.

Inquiries in the United States at the end of the year 1929 convinced me that a vast majority of those who joined in the nation-wide speculation of 1927 to 1929 were caught in the slump, losing in many cases all, or more than all, they possessed. So wide of the mark is the popular fancy that stock-market speculation on borrowed money is a hopeful enterprise. It is a curious fact that comparatively few, even among professional operators, are to be found often on the bear side. I have met hardened speculators who boasted that they never had done, and never would do, anything so immoral as to try to make money in this way 'out of other men's losses' by the fall of a stock. But a very little reflection will show that no code of ethics can make a valid distinction between betting

that a horse will win and betting that it will lose. It may be wrong to buy beyond your purse when things look cheap, or to sell more than you possess when they look dear. But there is exactly the same moral objection to either course, and of course there is nothing like a bear contingent to steady and check a falling market. The speculator for a rise who is trying to sell in a falling market has every reason to be grateful to the speculator for a fall who has sold 'short', and is therefore forced to buy stock in order to meet his obligations. Theoretically a successful operator should be capable of bearish and bullish moods, for, on the whole, over a period of normal years stocks and shares tend to maintain their general level, though great changes in price may result from great wars, which destroy vast quantities of capital and create vast quantities of Government debt, or from long prosperous periods of peace when capital accumulates and interest falls. But bear operations, especially on a large scale, are very dangerous, because there may be a shortage of available stock, and in that case holders may squeeze the bear to any extent and force him to buy back at ruinous prices. This may account for some of the almost superstitious objections entertained against bear operations. A shrewd old New York broker, just before retiring, told a young disciple, 'If I had to live my life over again I would always be a bull, but I would not always have an interest.' In other words, he would only speculate in a rising market. At other times he would be content with his commissions.

To return to Wall Street. Since the end of the Civil War it has seen many crises. The panic of 1873—when Jay Cooke came to grief and the New York Stock Exchange closed for ten days—stopped the construction of railways between the Great Lakes and the Pacific coast—a productive work which found peaceful occupation for the million disbanded soldiers of the Civil War, and had so solved what seemed the almost insoluble problem of that vast accession of idle men to the labour market. After five years' rest and recuperation another era of speculative expansion commenced in 1878, anticipating the resumption of specie payments, and lasted with many ups and downs for about six years, during which time many thousands of miles of railway were built parallel to, and in competition with, some of the most prosperous existing lines. The capital embarked in these new adventures proved, for the most part, unfortunate for the original investors; hence, after the panic of 1884 brought this second era of prosperity to an end, there followed a period of transition during which many new and at first unprofitable lines were being absorbed by older and stronger corporations.

Then came another outburst of speculation, marked by the entry of large foreign operators into the New York market, and by a great development of London's dealings in Americans, or 'Yankees', as they were called. A check to this was administered by the Baring crisis. But the collapse in New York was not quite due, and was postponed till 1893; its proximate cause being

the vicious silver legislation of the Unites States Government. A heavy cloud of depression hung over Wall Street until 1896, when Mr. McKinley was elected President on a straight gold platform. This restored the confidence of the moneyed interest, and laid the train for a new era of speculative activity. By the Dingley Tariff the profits of favoured manufacturers were enormously increased at the expense of the general public, and its passing was followed in logical sequence by the organization of trusts for the purpose of stifling competition and raising prices to the utmost limit of the protective and prohibitive duties. From a Wall Street point of view this chapter of economic history may bc called the capitalizing of the tariff. It lasted till the Stock Exchange and banking crisis of 1907—which has been noticed in a previous chapter. That disastrous collapse of credit started with a run on the Knickerbocker Trust in October, and ended in a suspension of cash payments which was continued for many weeks by nearly all the banks in practically all parts of the United States.

This crisis cost the American people dear; but it provided a useful lesson and had important consequences. For some time a lively controversy raged about its causes. Perhaps it may now be affirmed that unhealthy conditions caused by tariff and trusts on the one hand, and by imperfect currency and banking laws on the other, were responsible for the severity of the cataclysm. However that may be, the storm, after blowing down the whole fabric of credit, left behind it not

only a long and deep depression in almost every branch of industry but a widespread and apparently irresistible popular resentment against the Tariff. This resentment helped to return a Democratic President in 1912, and under Woodrow Wilson's first Administration the reforms planned by Republicans were moulded into a great constructive measure of currency and banking reform, which was fortunately put into operation before the outbreak of the European War of 1914.

The Federal Reserve System, as it is called, has stood the test of three successive crises in 1914, 1920–21 and 1929. The gold dollar currency has been maintained throughout. On the other hand the Federal Reserve authorities failed to prevent a most mischievous accumulation of gold, which contributed to the collapse of world prices and to the growing burden of war debts. It also failed to prevent a heavy crop of bank suspensions in the United States in the years following the War and especially after 1929. But these failures cannot fairly be charged against it.

I was in New York in October and November 1929, when the greatest of all Stock Exchange booms (lasting from the spring of 1927 to the autumn of 1929) was followed by the greatest and most disastrous crash in Stock Exchange history. I have told the story at length elsewhere.[1] Its main feature was the rapid irregular rise (with occasional breaks) from the summer of 1927 to the summer of 1929 in practically all the active common stocks of American railroad and industrial

[1] *Wall Street and Lombard Street*, Macmillan & Co., 1931.

corporations. The rise started on the theory that the stocks of many leading corporations were undervalued when their earning capacity—present and prospective—was taken into account. There was some basis originally for the theory; but in the course of 1928 cool critics saw that most of the stocks were rising to heights which no rational forecast of future earnings could justify. The whole country went mad. The gambling mania, fostered by banks and financed in margins, sent prices soaring upwards. Everyone bought because everyone else was buying; and because everyone believed that stocks would go up, they went up. All classes joined in the gamble. Many staked their last dollar; and many more borrowed more than they possessed in the confident expectation of making a fortune by betting that the shares of companies, about whose intrinsic value they knew nothing at all, would go up. So it went on, until at last in August and September 1929 some of the big interests began to unload, and European participants began to liquidate. The Hatry crash in London occurred on 20 September; and on the 26th the Bank of England raised its discount rate to 6½ per cent. to stop the drain of gold from London to New York, where money had been earning very high rates.

But the mob of speculators in the United States went on believing in their favourite counters for nearly another month. The first real crash came on 15 October, the second on 19 October (Saturday) and 21 October (Monday). On the 23rd there was an avalanche of selling. The panic had begun

in earnest. On the 24th occurred the widest break in prices and the most costly to stockholders since the war. All observers agreed that it resulted from compulsory liquidation due to exhausted margins and to a general fright which seized the gambling multitude all over the United States. Wall Street was swamped by selling orders. The panic was intermittent during November; but there was no sustained recovery. Those who were not ruined had lost confidence. In the month of October the market value of all the shares listed on the New York Stock Exchange fell by over 5,000 million dollars. No wonder that the purchasing power of the nation shrank, or that the *malaise* spread to the commodity markets. The slump took hold of trade. Buying of motor-cars, radios, gramophones, furs, silks and other luxuries (which had come to be regarded as indispensable) came almost to an end. As I write, nearly two years later, the agricultural and manufacturing depression in all parts of the United States is acute. The steel industry is operating at about 30 per cent. of capacity. Foreign trade is as bad as domestic trade. The foreign bond market is as flat as home industrial securities. Many of the wheat farmers and cotton growers in the Middle West and South are ruined, and many of their banks are insolvent. The numbers of the unemployed are variously estimated at from six to twelve millions. In short, the whole people of the United States are suffering with the rest of the world from such a collapse of trade, speculation and credit as we have never before seen in time of peace. The moratorium in Germany

has struck Wall Street as severely as it has struck Lombard Street. Clearly the financial history of the War is still unfinished in November 1931.[1]

[1] I am not competent, even if I had the space, to carry this history forward through the New Deal into the second Great War, which ended for the United States with a colossal debt and serious commitments.

CHAPTER V

GOOD SECURITIES AND THE ART OF INVESTMENT

After our survey of Stock Exchanges in the past and the present my readers will be prepared for some critical examination of the area and modes of investment. The difference between investment and speculation cannot be defined accurately; but everyone has a rough idea of a line which divides safety, with the certainty of a reasonable interest, from risk, with all its possibilities of loss or profit. The theme of speculation will be developed in our next chapter. Our present object is to direct the attention of the genuine investor, who wants his interest to be as high as is compatible with the safety of his principal, to some of the general rules and considerations that should limit and guide his choice.

The largest and most varied list of securities in the world is the London 'Stock Exchange Daily List of Officially Quoted Securities'. It now consists of twenty large pages. The price is sixpence. It is supplemented by another List of twelve large pages entitled 'The Stock Exchange Daily Supplementary List of Securities not Officially Quoted'. The price of this is also sixpence. Both Lists are published by the Trustees and Managers of the Stock Exchange, under the authority of the Committee, at 4 Copthall Buildings, London, E.C. Largely

as the result of the ever-increasing tendency both at home and abroad to give commercial and industrial undertakings the form of joint-stock companies, the London list has expanded very rapidly in the last half-century. Up to the year 1867 one page sufficed, then four till 1889, then eight till 1900, twelve from 1900 to 1902, and then sixteen, until it reached its present limit of twenty.

The Stock Exchange Official List[1] is subdivided into some forty different classes of widely varying importance. The largest group by far (owing to war debt) is the Consol Market, including British Government and Corporation Stocks, Colonial Government and Municipal Stocks, India Government loans and public boards like the Port of London Authority. The nominal value of this group was in 1931 about 8,000 millions sterling, to which the 5 per cent. War Loan contributed no less than 2,000 millions.

The Foreign Market, including the loans of foreign governments and foreign provincial and municipal issues, deals with a nominal capital far exceeding market values. Russian bonds, for instance, which before the war were worth £80 or £90 per £100 bond are now only valued at a few shillings. The nominal value of the foreign bonds issued in sterling exceeds 1,000 million pounds.

The Home Railway Market, another great group, has a nominal value in debentures, preference and ordinary stocks of about 1,200 millions. Large amounts of capital have also been invested in

[1] A third list is now (1946) published of inactive securities.

foreign, colonial and Indian railways. Then there are important markets in banking, insurance, shipping, gas, waterworks, breweries, and in mining, electricity, oil, rubber, industrial, financial and miscellaneous shares. The Miscellaneous Market includes a great number of British companies working abroad or in the colonies. In American railways, British capital came easily next after American before the war; but during the war, while the United States remained neutral, Great Britain had to support its European Allies and the Exchanges with the United States, which was selling us food and munitions at war prices. Consequently for these purposes our private investments in American railroad and industrial securities were sacrificed and added to the National Debt.[1] After the war the once active and often excited American market on the London Stock Exchange was reduced to lifelessness; but since then the arbitrage business with America has been revived by London's interest in a speculative group of Anglo-American securities such as gramophones, nickels, etc., which boomed in 1928 and slumped in the collapse of 1929.

Before leaving the list we shall do well to insist again, at the risk of repetition, that it is not always possible to buy or sell at the prices quoted. A jobber cannot be forced to deal. The real test of saleability is the column showing 'business done', which indicates clearly enough what are the active

[1] Further large amounts of American and Canadian dollar stocks were requisitioned by the British Government in the second Great War to pay for imports.

securities. Among inactive securities there are many (such as small but sound State and municipal loans) which are a matter of negotiation. On the other hand, small speculative securities such as most of the rubber and plantation companies, and many other commercial and industrial ventures, are easily got rid of when for some reason or other speculation flourishes, but are at other times almost unmarketable. The best markets for local industrials are often found on provincial Stock Exchanges, such as Glasgow, Manchester, Oldham, Birmingham, or Liverpool.

For investment purposes securities may be divided into public and private, the former being based on public credit backed by taxes (or rates), and the latter on private credit backed by profits, goodwill, and tangible assets.

The best Government loans, starting with British Consols and French Rentes, and ending with the Imperial and State loans of Germany, yielded at the close of 1910 from 3 to 4 per cent. interest. In 1898 they yielded only from $2\frac{3}{8}$ to $3\frac{1}{2}$ per cent. The change came about mainly through borrowings for wars and increased armaments which went on until the terrible explosion of August 1914. As a result of war inflation and the depreciation of belligerent currencies, the whole of the German and Austrian public debts were confiscated by issuing inconvertible paper money in place of the old gold standard marks and crowns. French investors in *rentes* lost four-fifths of their capital, and in other belligerent countries, except the United States, Great Britain and Japan, similar

frauds were perpetrated by the Governments. Open repudiation was the course adopted by Soviet Russia.

British Trustee Stocks—that is to say the securities in which Trustees may invest—were enlarged to include Colonial Government loans by Joseph Chamberlain when he was Colonial Secretary. This enabled the Dominions to borrow very cheaply in London and encouraged some of them —especially Australia and India—to borrow far too freely. A financial crisis struck Australia in 1930. Currency, credit and exchange broke down under the double strain of excessive debts and low prices for wool. Heavy losses overtook thousands of British investors who supposed that a trustee security meant a safe security.

With the increasing demands for public improvements of all kinds, municipal loans throughout the world are formidable competitors with national loans. Fortunately, the good municipal loans are generally well spent for purposes which are directly or indirectly profitable. The investor is also protected, as a rule, either by a sinking fund, or by a provision for repayment at par on a given date, or by a statutory limitation of the total indebtedness in accordance with the assessable value of the town, or by more than one of these methods in combination. No British municipality has ever, since the Municipal Corporations Act of 1835, failed to pay its interest punctually. Among the States of the American Union there were some scandalous repudiations in the days of Sidney Smith, which have been immortalized by the

stinging pen of that wittiest of economic and political writers. But, with comparatively few exceptions, the later record of North American and colonial towns has been fairly good, and their credit generally stands deservedly high. But as the coupons upon the city bonds of the United States are not payable in London, they are of little interest to English investors. Some care should be exercised in regard to the size of towns; for, in some British self-governing colonies, villages which might almost be wheeled out of the municipal area in a single night, used to call themselves 'cities', and get their bonds hawked about in London.

To judge the value of second-class public securities requires a rather wide knowledge of political and financial conditions. A rough criterion is the market's own appreciation. But the value of its judgement is rather technical as between different securities of the same class. Too often it fails to discriminate adequately between loans for war or armaments, or loans to meet budget deficits, and loans for capital and reproductive purposes. Heavy losses in Australia, Brazil, Chile and many other countries have fallen on British investors in consequence. But a nation groaning under a dead-weight debt contracted for war is in a much inferior position to that of countries like Sweden, Denmark, or Holland, which remained neutral and have not borrowed either so much or for merely destructive purposes. And in the same country there may be many public issues of very varying merit. Thus a close study of the various

Brazilian and Chinese bonds will show why some are considered better than others, and so yield lower rates of interest. Similar distinctions must be made in the case of Home Railway Debentures and Preferences, even though they may all be listed as Trustee Stocks. As a rule, in the case of countries which are financially weak and over-burdened with debt, the market prefers loans specially mortgaged on some branch of the customs or inland revenue. A good many post-war loans, such as the League of Nations loan to Danzig, are of this character.[1] In countries with rising credit the lower interest loans standing well below par are the most attractive. A railway bond guaranteed by the Government has a double security, and may in some cases be preferred to a direct Government issue. Indeed, the unguaranteed bonds of the best British railway companies in South America often yield a lower rate of interest than those of the Government whose territory they serve. Generally speaking, investors, who do not wish to risk their capital, should avoid most of the national, municipal and provincial issues of South America, as well as all Central American loans, and the loans of Baltic and Balkan countries. To judge by experience and present conditions, Argentina, Uruguay and Brazil are the least insecure of South American States. But even in these there are elements of political danger, financial incapacity and social disorder which cannot be overlooked. In 1931, for example, Chile, after over eighty years

[1] All the League of Nation loans have now (1946) either defaulted or been confiscated by the Soviet Government.

of solvency, declared a moratorium on its foreign debts, and Brazil followed suit.[1]

Turning from public to private securities we are faced by an entirely new set of considerations, and the task of the investor is far more difficult and complicated. By a skilful and cautious use of local knowledge a careful buyer may often secure for himself a high rate of interest with comparatively little risk. But even so he will be well advised not to entrust all his eggs to one local basket. In case of the accidents and misfortunes due to unforeseen frauds, or unsuspected mismanagement, or fashion, or competition, any local concern may come to grief. A town or part of a town may decay, an industry may decline, the values and rents of lands, houses, factories and shops may shrink and dwindle away.

Let us now pass to the technicalities of joint-stock companies — their bonds, their preference stocks and their ordinary shares, and to the general merits of the security which various species of undertakings offer.

Until recent years, railway enterprise was probably the most productive and profitable of all investments. The early promotions of course contained a large sprinkling of swindles. The railroad pioneers were often of the buccaneering type —a type not yet extinct in new countries. But in the average case where promoters attained an average standard of honesty, and engineers an average standard of skill, the faith of the investor was justified. Until the coming of motor-cars, and

[1] Later history down to 1946 confirms these warnings and prognostications.

the vast expenditure on motor roads, no invention for land transport had appeared to vie with the steel car, drawn by steam or electricity along steel rails, in cheapness and celerity. It might seem that steamships should provide equally attractive openings to an investor. But here a vital difference emerges. Almost every railway enjoys at least a partial monopoly. It has a route fixed and permanent, which no competitor can use without its consent. Until motor-cars and motor-buses provided an alternative, the people along the route had to use it for travelling or freight. But the sea is a public highway open to all. No shipping company can exclude a competitor, though in practice, on particular routes, competing companies may agree to avoid undercutting by 'conference' rates for a time. Nevertheless, as soon as a lucrative monopoly begins to be enjoyed, another company, or a swarm of tramps, is apt to appear on the scene. Tramways and bicycles no doubt reduced short-distance passenger traffic in some places, but they also acted as feeders to railway lines. But tramways are being superseded by motor-buses, and railways in the last few years have been hard hit by motor traffic on high roads. There may also be a future danger to railroad investors in aeroplanes, though at present the peril seems to attach to the persons rather than to the competitors of aeronauts. No mode of rapid transit can compare with railway travelling for security. On British roads alone, motor vehicles are now killing about seven thousand persons a year, and maiming for life a far larger number.

Telegraph companies are threatened by telephones and wireless, but are not yet obsolete. The telephone is a quick substitute for the personal interview. The telegram is a quick substitute for the letter. Each has its special use, and therefore the capital invested in each may continue to yield interest.

It would be possible to fill many pages in this way discussing the probable future of the different branches of commerce and industry into which capital is being and has been poured by investors. But our special purpose here is to define broadly what is a satisfactory security, leaving the investor to allow for the possibility of any particular business being superseded by the invention of a superior process or a cheaper substitute. And here it may be well to begin by accepting, with limitations, the received opinion that, in the sphere of private or commercial as distinguished from government and public stocks, the best security is a first mortgage upon any flourishing enterprise which can offer ample assets. But not every undertaking can provide satisfactory security for the issue of bonds. In fact, it may almost be said that a real freehold estate, with a market value considerably above the total issue of first mortgage bonds, is the only case in which a first mortgage in itself offers anything like an impregnable security even in a stable and civilized country. For this purpose, pastoral or agricultural land is superior to urban values, as it is generally subject to less violent fluctuations. But even here there is the possibility of a confiscatory land tax—which will reduce heavily the selling

value of the lands of a pastoral company, and so endanger the capital even of those who hold first mortgage bonds on the property. The value of a first mortgage rests on the fact that if the interest is not paid the mortgagees can immediately seize and sell the property. Where the property consists of real estate, timber, or other valuable and marketable goods in ample amount, and the courts of justice can be relied on, the security may be called perfect. But in nine cases out of ten the property of the corporation or company owes most of its value to the undertaking as a whole. As E. S. Meade put it, in his excellent treatise on *Corporation Finance*:

> When the property of the company is specialized to the use of a particular business, such as a railroad or manufacturing plant, where the business must be carried on in a certain place and by people who are skilled in its management, and where the property, once devoted to a particular use, can be turned to no other use, the real security of the creditor is not the property but the earnings of the property.

On this view the much-vaunted first mortgage on a railroad owes its value to the fact not that it enables you to sell the property, but that it is a first charge on the earnings. In other words, the American first mortgage bond is little better than the floating charge of an ordinary English debenture, and if the surplus earnings in bad times are less, it is really less valuable. Other things being equal, a well-covered first preference is almost as good as an equally well-covered bond or debenture.

Let us put the American first mortgage bond to the practical test of bankruptcy.

If we look at the actual wording of the 1897 mortgage securing 'the first lien convertible four per cent. gold bonds' of the Union Pacific Railroad Company (a typically gilt-edged investment though the line was in a receiver's hands not long before) we find that it assigns to the trustee all the several lines of railroad, property, terminals, premises, etc., belonging to the railroad company. Under this and other mortgage deeds the trustee for the bondholders has large and sweeping powers over the property of the corporation in the event of bankruptcy. He can, in theory, sell the property, or enter upon it and operate it, applying the proceeds or revenues to the liquidation of its debts. In theory, I say, and according to the letter of the law, the property of a corporation which fails to pay interest on its bonds, or to meet them when due, is to be seized by the trustee and sold. It is for this that the mortgage deed was drawn, for this that the trustee exists. A similar procedure is actually carried out in small bankruptcies. But in large affairs the American law does not work. Just as, in a panic, American banks are allowed to suspend cash payments without closing their doors, so (to quote our previous authority) 'the theory of the corporation mortgage cannot in many cases be carried out'.

How, then, is the mortgage made null and void, and 'the property protected against its creditors'? It is done 'by invoking the aid of a court of equity'. A receivership is the easy and comfortable haven

into which in troublous times an American corporation steers. I am not exaggerating. In Meade's words, 'at the first threat of disaster' the directors, 'who see long before any creditor the impending insolvency of the company, fly to the shelter of a court of equity'. Equity shields them from the law, and bars the best secured creditors from their legal remedy. The judge usually appoints the chief lawyer of the bankrupt corporation, or possibly even its president, as receiver. Or he may, and often does in smaller cases, appoint some unsuccessful lawyer connected with the court; for a receivership is a paid office, and receiverships, especially in bad times, are large fountains of patronage.

To get the money or substitute for money that he needs to carry on the business, the receiver usually resorts to what are called 'receiver's certificates'. A receiver's certificate is 'a short term note secured by a first mortgage upon all the property in the receiver's hands'. The plight of the first mortgage bondholder may now be imagined. He has not only lost his legal remedy for recovering his principal, but an equitable first mortgage has been put in front of his legal first mortgage. When, therefore, the first mortgage bond of American law is put to the sole test for which it was intended, it only too frequently proves to be not worth the paper it was written upon. In course of time, no doubt, the interest on the bond may be resumed, and its value may be restored. But it is not in practice the security which it professes to be in theory. Equity has taken away what law gave. Over a period of thirty years previous

to the War of 1914, an ordinary stockholder in a sound and well-conducted company like the Pennsylvania was better off for dividends, and better secured as to principal, than owners of the highly-valued first mortgage gold bonds of many American railroad corporations.

To Americans, of course, these warnings are hardly necessary; but bonds of industrial corporations in North and South America have been so widely and skilfully advertised in London that the guileless investor, unaware of precedent and practice, fancies that he has got hold of a gilt-edged security with a fairly high rate of interest, and that even in the event of bankruptcy his capital must be returned to him intact. This is a complete delusion. In most cases he is an unintentional speculator in loss, with very little to gain in case the company, after default, becomes a prosperous concern. From this point of view he would do far better to buy preference stock with a cumulative dividend. The bond buyer in a rickety railroad or industrial corporation surrenders the chance of participation in increased earnings in exchange for the doubtful guarantee of a fixed rate of interest and a legal document (which will probably be dishonoured) entitling him to prompt possession of a bankrupt property in case of default.

American bonds are either for long or short terms. Of the long term bonds suitable for the ordinary investor, there are three main varieties, namely, first and second mortgage bonds, collateral trust bonds, and car trust (or equipment) certificates. Owing to the established doctrine of receiverships,

none of these can be called perfect securities. In every case the security depends upon the prosperity of the company or corporation and the amount of surplus revenue which remains after the interest on the bond has been paid. Provided a property is otherwise free and there is a guarantee that it shall remain unencumbered, I can see little to choose between a first mortgage bond, an equipment bond and an ordinary debenture. But if there is any risk of bankruptcy the would-be investor, who is really in search of safety, should turn aside from the glittering bond and buy a public security issued by some respectable government or municipality, whose debts and taxes are reasonably low.

A debenture may be defined as a certificate of debt issued by a corporation or company, without mortgage or collateral security. In the United States the debenture holder is legally an unsecured creditor; the bondholder is legally secured but equitably unsecured. What the debenture holder possesses is (1) a prior claim to earnings, and (2) a right of action against the company if they fail to pay him his interest or to repay him his principal when due. Of course, if there is a first mortgage upon the property of an undertaking which has issued debentures, a first mortgage bond is better than a debenture. The purchaser of a debenture should take care that this is not and cannot be the case. The so-called income bond is a bond on which the interest or income is only payable according to the discretion of the directors, though in the event of a receivership the principal must ultimately be repaid if the money will go round. In this

respect it is superior to preference stock, but as the interest of an income bond is not cumulative, it is in another respect inferior to a cumulative preference. The objection to bonds of all kinds in countries whose courts do not allow the legal security to become effective has now been clearly stated. The capital may be lost or locked up for an indefinite time in a receivership. Otherwise the value of a specific security is, as we have seen, greatest where the assets of the company are really saleable apart from its goodwill as a going concern. A land or pastoral company, or a well-situated shop with a valuable site, are cases in point. Machinery often proves almost worthless when an industrial company goes bankrupt. In England a right of foreclosure is real and may be effective; and a debenture with a trust deed containing this right, and attaching sufficiently valuable freehold property to the debentures for the purpose, safeguards the security of the principal, apart from the earning power of the concern. Provision for a sinking fund is another valuable item that may appear in a debenture trust deed; and if the deed is properly drawn, and the assets attached are not undervalued, it will be found that the price of the debentures will shrink comparatively little when the profits of the company dwindle. This is naturally the reverse of an American bondholder's experience when his corporation begins to go downhill towards a receivership.

To sum up the matter. An investor who really wishes to sleep over his debentures, and is not disposed to haggle about a quarter or half per cent.,

should first and foremost look to see what margin there has been of earnings over and above fixed charges in years of depression. Next he will read the trust deed, if any, to see the nature of the debenture or mortgage issue. Then he will find out what sort of consideration the courts of justice of the country or State in which the corporation is formed are accustomed to give (*a*) to bondholders in case the concern goes bankrupt, and (*b*) to foreigners. English investors often find that litigation in foreign courts is merely throwing good money after bad. A British company, whether working abroad or at home, is certainly to be preferred to a foreign company, other things being equal. American company law varies from State to State, and is often unsatisfactory. Lastly, let the investor keep always in mind that an ill-covered bond, so far from being a gilt-edged security, may be of all speculations the one least likely to prove profitable.

When we leave debentures or bonds to buy company stock we put aside all thought of trying to secure our principal in the event of failure and bankruptcy.[1] As a rule, the purchaser, even of a preference stock, can only claim that it ranks before ordinary stock in the distribution of earnings. True it is sometimes provided that in the event of a company being dissolved or wound up, either compulsorily or voluntarily, the holders of pre-

[1] But when a government goes bankrupt through currency inflation—as Germany did after the first World War—the lucky investors were those who held ordinary shares. Bondholders lost everything. In 1948 inflation threatens all holders of fixed interest securities in most civilized countries.

ferred stock shall rank before the holders of ordinary or common stock in the distribution of assets. But in such cases there are not likely to be any assets left after the creditors have been satisfied. There are various other legal devices by which the technical position of a preference holder may be strengthened in the articles of association or incorporation, and of these, perhaps the most valuable is a limitation on the power of the directors to mortgage the property; for of course mortgages and debentures take precedence of preferred stock, and every addition to indebtedness impairs the position of preference shareholders. The main division of preference stocks is, however, into cumulative and non-cumulative. 'Cumulative' means, in the case of companies whose profits fluctuate heavily, that in good times the preference shareholder may hope to recover in a lump the dividends which he has lost in whole or in part during periods of depression. But as the control of a company is usually possessed by the common stock, it often happens that this right has to be compromised during a reconstruction. That is to say, in order to avoid a winding up, in which everything might be lost, the preference shareholder has to consent to forgo his past claims for the sake of keeping the company and his future hopes alive. But, of course, the cumulative type is far the better. The ordinary stock of good railways may prove an excellent investment in times of depression and bad trade. Concerning the common stock in American industrial companies, a critical student once observed: 'It is usually sold at a

low figure, liberal representations concerning anticipated earnings being made to influence its purchase. These representations are not often realized.' But in the boom of 1927 and 1928, which collapsed in the Wall Street crash of 1929, common stocks rose to incredible heights, and all connexion with earning capacity was lost to view. But it is also to be remembered that after the War of 1914–18, when holders of fixed interest securities in Germany, France, Italy, Belgium, and several other countries lost all, or nearly all, their capital, the ordinary shareholders in many companies came off quite well.

One or two general observations upon investments in both ordinary and preference shares may fitly close this chapter. In the first place, a natural monopoly or a franchise conferred by public charter is the most stable basis for investment. The most dangerous imaginable prop for a company to rest upon is a bounty or a protective tariff which may at any time be withdrawn or swept away. An industry which flourishes without tariff aid in a protected country is presumably in a very strong condition. The most important consideration of all is the management, and here the advantage of investment in a local concern with which the investor is well acquainted can readily be perceived. If some change in the management occurs of which he disapproves, he can probably get out without much loss (if there is any sort of a market) before the concern begins to go downhill. Last, but not least, the time to invest in industrial and commercial enterprises of all kinds is in periods of

trade depression, when dividends and prices are low. A prospectus of a new company usually appears in moments of buoyancy and prosperity, and on such occasions a subscription is likely to prove unfortunate. But this consideration does not necessarily apply to new issues of well-established companies, which may at any time require more capital for the profitable extension of business.

CHAPTER VI

SPECULATIVE SECURITIES AND MODES OF SPECULATION

Even in an old and conservative country like England the average investor is a speculator in the sense that he not only wishes his investment to yield him interest but also hopes and expects that he will some day be able to sell out at a profit. Such an aspiration is perfectly natural and legitimate. Anybody who has large sums to invest will very properly ask: 'Is this a good time for investment?' meaning, of course: 'Are stocks just now cheap and below their normal level?' Thus, towards the close of a war the credit of the belligerents is apt to be abnormally low, and so long as there is enough revenue left to pay interest on the debt there is a good opportunity for investment. Many investors in England and France made very handsome profits by buying Spanish bonds during Spain's war with the United States, or the bonds of Russia and Japan when those two Powers were at war in Manchuria. In this respect speculative panics and banking crises resemble wars. Immense profits were reaped by purchasers of American railroad stocks in the autumn and winter of 1907, when the American market, owing to the complete collapse of credit, was in a state of prostration, and dozens of sound securities had fallen 50 per cent. below their normal value. But when stocks or

commodities are really cheap the public is usually timid: when they rise to absurd heights it rushes in and buys madly. A man really seems to require a great and unusual amount of courage to buy freely when securities are cheap, and none at all to buy when they are dear. People think and act in mobs; and the speculative fever always rages in an atmosphere of high prices.

But a very sharp distinction must be drawn between the speculator who buys speculative securities, or 'rubbish', and the speculator who buys sound investments stocks. Thus in the American market before the War of 1914 there were well-known gambling counters such as Erie or Wabash or Southern Common—non-dividend payers—which seemed to have no intrinsic value and therefore moved very rapidly in times of excitement. There was all the difference in the world between these and the Union Pacific, which had paid a dividend of 10 per cent. for several years past. And yet between 1904 and 1910 the Union Pacific fluctuated between a maximum of 211 and a minimum of 74. Most remarkable certainly—almost romantic—is the history of this line. An old friend of mine well remembered buying Union Pacifics at 8 and selling out at 13. In periods of excitement these marvels used to be dilated upon, and new Harrimans were conjured up who might perform similar wonders with the Erie or the Southern Railway. But nearly all markets have rubbishy shares which serve as gambling counters. Thus the foreign market has Russian, Turkish, Roumanian and other repudiated

or defaulting securities in Europe, as well as the bonds of Chile and other defaulting states, or provinces, or municipalities, in Central and South America. Every industrial market has ordinary shares in well-watered companies which may have been successful in their day, but are now practically hopeless. Even our staid Home Railways have weaker brethren, whose heads have been dipping below the dividend line as a result of road competition, trade depression and, in some cases, bad management.

But there is one whole class of securities which are essentially speculative from causes peculiar to themselves. The mining markets and the market for shares in rubber plantations are speculative, not because they yield no dividends but because, owing to wide fluctuations in the gold price of tin, copper, rubber, etc., it is so difficult to form a correct estimate of their value from month to month or from year to year. There are the silver mines of the United States, Mexico and Canada. There are copper mines innumerable in all parts of the world, from Riò Tinto, most ancient and renowned of all, in Spain, to the latest American and Rhodesian discoveries. There are the old tin mines of Cornwall, the modern tin mines of Malay and the modernest of Nigeria. Nor have we mentioned the gold, silver and copper mines of Australia, among which Coolgardie and Broken Hill are pre-eminent, or the gold mines of West Africa, familiarly called the Jungle in Throgmorton Street. There is also the great De Beers monopoly of diamonds at Kimberley—a monopoly

created by Rhodes and Beit, but threatened by discoveries in the Orange Free State and South-West Africa.

The South African gold mines, especially those of the Rand, which have formed the Kaffir Market for the last forty years, stand in a class apart both because of their output, and because their shares rise with the purchasing power of gold. In other words, they have gained by the collapse of prices which has hurt silver, copper and tin mines.

The Mining List of the London Stock Exchange contains a vast selection of good, bad and indifferent companies. But even the best are rather speculative. And why? First of all, they are dwindling securities. A mine which has yielded an average of 10 per cent. in dividends for the last five years looks very cheap, but may be very dear; for it may not have more than ten years of profitable life. Buying shares in a successful mine is a little like buying the unexpired lease of a house without knowing the date at which it will expire.

In the second place, however honestly, however scientifically conducted a mine may be, it is practically impossible in nearly all cases (even assuming the market value of the ore to remain stable) to estimate at all accurately its value for investment. When will the mine be worked out? When will it cease to pay? Nobody knows; even the experts can only guess, and their public guesses are not always believed. The truth is that, in the flotation and finance of mines, engineers and geologists play very much the same part that valuers do as witnesses in arbitrations and rating

appeals. It is their business to make out the best valuation they can for their clients; and every mining failure in the world has been introduced to the credulous public by highly coloured pseudo-scientific 'reports' from 'eminent geologists'.

Gold exercises a mysterious attraction over the uneducated mind, especially in the City and on the Stock Exchange. A tiny parcel of gold is watched with far more interest than a large cargo of mutton. The very elect are sometimes strangely excited over the import or export of a few thousand sovereigns or a small quantity of bullion. Hence it has been found easy to float a gold mine on less evidence of the existence of gold than would be needed in the case of less precious metals—though perhaps 'Baron' Albert Grant's 'Emma' silver mine might be cited by partisans of the white rival. The unfortunate purchasers of Emma shares found out afterwards that there was neither silver nor title, and eventually for every £20 subscribed they received back only a paltry shilling. Most people have heard the punning epigram—

> Titles a king can give, honours he can't:
> Titles without honour are but a Baron Grant.

But it is less commonly known that after the Emma Silver Mine fiasco some wit added—

> Yes, but you're in an even worse dilemma
> If you cannot get a title to your Emma.

Nevertheless, while the ordinary mining prospectus should be put into the wastepaper basket by anyone who is not a mining expert with special knowledge, well-established mines of all kinds,

from coal to gold, are legitimate, useful, and often profitable ventures. If the risk is well understood and well distributed, and if the wasting character of the securities is generously allowed for by the recipient of dividends, there is no reason why people of fortune should not include a proportion of mining shares in their holdings.

The degree of risk that attaches depends largely upon the nature of the product. Gold, in the century preceding the War of 1914, proved itself a remarkably stable standard of value, thanks mainly to the fact that its annual output is only a small fraction of the world's gold stock. In consequence of demonetization caused by the War its purchasing power fell swiftly, but has since increased again, especially since the Wall Street slump of 1929, to about where it stood in 1913. Of course the nominal price of gold in a country with a gold currency does not vary at all. Until the suspension of the gold standard, an ounce of standard gold bullion was coined into £3. 17s. 10½d. But people seldom took gold bullion to the Mint, as they would have to wait some time before receiving the coin. The Bank of England acted as an intermediary. It took gold at £3. 17s. 9d. and paid cash, the difference of three halfpence per ounce between the Bank price and the Mint price representing the Bank's discount and its charge for the work involved. After the closing of the Indian Mints in 1893 to the free coinage of silver, the Indian rupee was converted into a token coin, and so became a silver representative of a gold standard. South Africa coins sovereigns both for internal purposes

and for export. The currency of the United States was until the crisis of 1929–32 a full gold standard, the units being the gold dollar weighing 25·8 grains and the gold eagle (or ten-dollar piece) weighing 258 grains. An English sovereign or pound note exchanged under the gold standard for about 4 dollars 87 cents. The price of gold is necessarily invariable in countries with a real gold standard, where the Government undertakes to coin gold at a fixed rate by weight. But the real price or value of gold is not immutable. As a matter of fact it varies in exchange value always and everywhere. For the real price of gold is its purchasing power. In a silver-standard country the price of silver is fixed and appears not to change, while the price of gold changes constantly, being the amount you can purchase at any time in the standard silver coin.

Hence in Great Britain (from 1925 to 1931) or in the United States, when we talked of rising or falling prices, we were talking of gold prices. When we said that 'prices are rising' we meant that the value or purchasing power of gold was diminishing, and when we said 'prices are falling' we meant that its value or purchasing power was rising. It is, therefore, wrong to think of a gold mine as producing a metal whose value is fixed or permanent. Its price in a gold-standard country is fixed, but its value varies. Gold mining shares are naturally inclined to rise or fall with the value or purchasing power of gold.

After gold probably silver and iron and coal come next in order of stability; though silver has

allen enormously (with violent fluctuations) in the ast sixty years. From 1868 to 1872 the average price of silver was 60 pence per ounce. In 1902–3 t fetched only 24 pence. At the end of the 1914 Var the gold price of silver rose for a short time o over seventy pence. Then it fell rapidly, until early in 1931 it dropped to little more than a hilling an ounce. Iron mines are now very largely owned by iron and steel companies, of which the hugest example is the Steel Trust of the United States—a vast concern built up by Mr. Carnegie and sold on his retirement to Messrs J. P. Morgan & Co., who formed thereout the Billion Dollar Trust. It is said to own something like half the ron ore of the United States, and it manufactures all kinds of iron and steel goods. It has also the listinction of being by far the most important of hose United States industrial corporations whose ecurities are dealt in freely on the London Stock Exchange and quoted on the London Stock Exchange List. Its debentures are probably at east as good a security as those of a first-class railway company. A good deal of water was queezed out of the ordinary shares by the application of profits to capital. These shares rose high —far too high—during the boom of 1928–29, and hen fell heavily. They may now (1931) be at an attractive level, for their profits ought to be ncreased rather than diminished, if a sweeping reluction of the American Tariff—now a possible if not a probable event[1]—should be effected, bringing

[1] It is more probable in 1948 than it was in 1931, as the United States is now the only great creditor country.

with it a diminution in the cost of production. That the American iron and steel industry, like its chief customer, the American motor industry, needs no protection is generally admitted.

No doubt the most speculative ores are copper and tin, and in these cases the investor must expect his shares to fluctuate as wildly as the metals. A boom in trade usually raises the prices of tin and copper far above their normal level, and a slump like that of October 1907 or 1929 causes a corresponding dip or depression. Thus between 1904 and the spring of 1907 the price of copper nearly doubled, and that of tin rose about 40 per cent. Tin, however, is more easily cornered than copper, as the output is much smaller.

Speculation in a metal soon brings about an inflation of the shares, and when the bubble is pricked many of those who fancied they were successful investors awake to discover that they have been unsuccessful gamblers. The shadow thrown by commodity prices on share prices is often a long one, simply because a small fall may wipe out profits and dividends. Thus the movements of copper company shares are apt to be far more violent than those of copper. The shares of Amalgamated Copper fluctuated in 1904 between a lowest of 44 and a highest of 85, in 1907 between a lowest of 43 and a highest of 124. Similar fluctuations in base metals and in the shares of the mining companies that produce them occurred between 1928 and 1931.

A comparatively new commodity, rubber, has outdone even copper in rapidity of movement;

for its price moved in the first decade of the century from 3s. per lb. to 12s., and back in the summer and autumn of 1910 from 12s. to 6s. After the War of 1914 its price fluctuated from a few shillings to a few pence. Until about 1907 practically all the rubber marketed was 'wild' rubber; that is to say, it was obtained by tapping wild rubber trees, mainly in Brazil and the Congo. Fortunately for humanity — seeing that the collection of wild rubber, especially in the Congo, involved the most atrocious barbarities — it was discovered that the 'Hevea Brasiliensis', the best variety of rubber tree, can be cultivated successfully in the Malay Peninsula, Ceylon, and some other tropical countries. A few of the first experimental plantations produced remarkable results, and already in 1908 and 1909 a good many Englishmen and Scots, who had special knowledge of their own, began to invest in rubber plantations. Towards the end of 1909, as rubber rose in price, owing to a greatly increased demand from the United States for motor tyres, etc., it began to dawn on the public that rubber investments offered phenomenal profits. Just because a few skilfully managed plantations, with rubber at an exceptionally high price, did really seem to be worth many times the original capital, it was assumed that rubber trees could be planted by anybody almost anywhere so as to yield similarly marvellous results. The London company promoters saw their opportunity. The public was evidently 'on the feed'. It wanted rubber shares, and it got them to the tune of many millions in the spring of 1910. There

were plenty of unsuccessful planters of tea, coffee, etc., in Ceylon and Malaya, who were delighted to sell 'suitable' land at some high multiple of its true value. So boards of directors were assembled, printing presses were set to work, and hundreds of rubber plantation companies were floated upon a credulous and voracious public. Clerks and office boys, footmen and nursemaids, subscribed with eagerness, and followed the tips of the *Daily Menace* with the unsuspecting simplicity of their masters and mistresses. It was a sad example of plundering and blundering. Never, perhaps, since the Kaffir boom had so many small savings been transferred into less meritorious pockets. Nevertheless, many good companies were floated with profitable results for the investors, who reaped for many years (on an average) high dividends.

But the distinctions between speculation and investment are by no means exhausted by merely regarding the quality of the purchase. It is true that a man who buys a new mine, or puts his money into a new rubber company, is a speculator, while a man who buys Consols or a good railway debenture, or puts his money into a new issue of an English municipality, is an investor. But there is plenty of speculation in gilt-edged securities; and in ordinary times the typical speculator is the fool who gambles with borrowed money. A man with £100 who buys a Central American 'security' and puts it away in the hope that (though it yields him no interest) it will rise before long and enable him to clear out at a handsome profit is far less likely to suffer than the man who buys, say, £5,000 of

some good security for the account, and uses his hundred pounds to pay contangoes and differences. How heavy are the odds against this sort of speculator we have shown in our chapter on Wall Street. But as long as civilization lasts people will go on playing this foolish game in the face of all experience. Just as in the case of a lottery the chance of a gain outweighs the probability of a loss.

A correspondent of mine once inquired: 'Is 6 per cent. necessarily speculative? Is 8 per cent. only to be had from speculations? Is it gambling to buy mining shares which yield anything between nothing and 15 per cent.? Where can the line be drawn?' A stockbroker, being asked wherein consisted the difference between investment and speculation, answered that speculation means dealing for carry-over purposes, while investment applies to any case where the purchase is paid for. Another, with a sophistical turn of mind, held that the real distinction depends on the intention of the purchaser. If a man buys a security and takes it up to hold he is an investor, no matter what the security may be, no matter how rash or prudent the choice. On this view there are different kinds of investors. Thus one buys gilt-edged securities if the chief object is to make absolutely sure of regular dividends; or, again, if the main desire is to have a large income, another will buy ordinary and preference stocks with a high yield regardless of risk. Lastly, those who aim at a future appreciation of capital rather than at immediate or regular dividends may buy a speculative stock like Mexican

Eagles, or Steel Common, or some unlucky industrial, which appears to be struggling out of its difficulties, intending of course to watch it carefully and look ahead (which is what the word 'speculation' implies), whereas the gilt-edged man prefers something he can sleep over. Upon this view speculation comes in where the buyer's intention is not to pay but to get out with a profit if possible before the end of the account, or after a series of continuations at some future account. Such a man may fairly be said to be playing or gambling with his money, and not dealing with it seriously or permanently as it is the intention of an investor to do. I am not quite satisfied to allow the distinction between speculation and investment to rest upon intention. The foundation is rather too slippery. It reminds me of the eminent statesman who, at an early stage of our fiscal controversy, argued that the question whether a duty is protective or not depends upon whether the Government imposing it *intended* it to be protective.

If, as a matter of fact, a man is running risks and is speculating, he cannot be called an investor on the ground that he is unaware of the fact that he is running speculative risks. Perhaps a distinction may be drawn, however, between a member of the outside public and a person who is actually in the market. The moment an outsider begins to borrow, and gets out of his depths, he is certainly gambling or speculating, even if the stocks he is interested in are Trustee securities. On the other hand, a member of the Stock Exchange, who makes

a regular business of buying and selling shares, can hardly be called a speculator in any vicious sense if he works with borrowed money. A member of the Stock Exchange almost always has an interest in the market, and probably uses his credit freely; but it is difficult to see much difference between him and a wholesale dealer or merchant in wheat, cotton, wool, etc., who often has to rely on his banker for 75 per cent. of the value of his purchases.

So much for the difference between speculation and investment. But we have still to touch upon the technical side of the subject, which calls for a brief statement of the mode or modes of conducting speculation on the London Stock Exchange; and for this purpose we may accept as a practical definition of the speculator a person who interests himself in the temporary fluctuations of shares, who bets or wagers (though not within the meaning of the Gaming Acts) that certain securities will rise or fall. If the contract were a gaming contract within the meaning of the Gaming Acts it would be null and void in the eyes of the law, and neither party would be able to enforce it. The reason why a speculative contract with a Stock Exchange broker is legal and enforceable is that the motive of the buyer or seller has nothing to do with the contract. The broker may not, and often does not, know whether his client will take up the purchase, or whether he will actually part with the stock which he instructs the broker to sell. One plain difference between a Stock Exchange speculation and a bet upon a horse is that in the case of the bet one party loses and the other gains, whereas if

A commissions B to buy him £100 of shares and they rise to £110, B loses nothing by paying £10 to A on the conclusion of the account. But, generally speaking, when speculation in stocks is carried on with an outside broker or 'bucket shop' (i.e. between two principals) the law holds it to be a gaming contract. This is in itself a sufficient reason against speculative persons dealing with these establishments. If they win heavily they will very likely not be paid.

The reader will probably have a pretty clear idea from previous chapters of the two kinds of speculation—for the rise and for the fall. The Bull, who speculates for the rise, buys stock, and the Bear, who speculates for the fall, sells it. The one buys in the hope of selling at a profit; the other sells in the hope of buying back after the stock has cheapened, and so pocketing the difference. A bear operator is said to sell 'short' because he sells what he has not got, and when the time comes to fulfil the contract he has to borrow stock. As the fluctuations of stock—their ups and downs—must on the average over a long period be more or less equivalent, it would follow that the operator least likely to lose would be the person with a 'flair' for the market who was just as ready to be a bear as to be a bull. But as a matter of fact the great majority of speculators are always bulls. Optimism seems to be of the essence of speculation. A boom like the Kaffir boom, or the rubber boom, or the Wall Street boom of 1928–29, requires the enthusiastic co-operation of a credulous public. The public understands how it may make money

out of a rise, but it cannot understand how to make money out of a fall. So it will borrow for the rise but not for the fall.

On the London Stock Exchange, except in the Consol Market, there are 'fortnightly' accounts, varying from 14 to 21 days. The actual account or settlement covers four days: (1) Contango Day; (2) Mining Ticket or Name Day; (3) General Ticket or Name Day; (4) Account Day, often called Settlement, or Pay Day. Account therefore means either the whole 14 or 21 days over which an account runs, or the actual days of settlement, or the Fourth Day of the Settlement. For 'Contango' another name is 'Continuation' or 'Carry over'. On Contango Day, members who want to postpone settlement of their bargains carry them over to the next account. Ticket or Name Day is for the delivery of securities which have been bought by one member from another during the account. The ticket is handed by the buyer to the seller. It bears a description of the securities purchased and their price, etc., and constitutes a demand for their delivery. The process of passing tickets is expedited by the Clearing House, which clears securities as the Bankers' Clearing House clears cheques. Stocks and shares bought or sold for the current account must be either paid for when delivered, or carried over (continued) on Contango Day.

A speculator for the rise, who does not wish to cut a loss or realize a profit, instructs his broker to carry over or continue his shares. In that case the transaction is postponed for a consideration, and

interest is charged for holding over the stock to the next settlement. This interest is called the contango rate. Thus, as a rule, the bull pays a contango rate, and the bear who is speculating for a fall is said to 'take in' the securities and to receive the rate or contango. But sometimes, in a depressed and bearish market, the bear has to pay a 'backwardation' instead of receiving a contango. It is all a question of demand and supply. If there is a demand for money and a plentiful supply of stock there is a contango; if there is a scarcity of stock for delivery against sales there is a 'backwardation' to be paid by sellers who are short of stock. If on balance there are securities which cannot be adjusted, the bulls have to pay for an excess, or the bears for a deficiency. In the case of the bears this means either delivering the stock they have sold, or borrowing it from a holder, undertaking to replace it on the next account day. All this is very difficult and technical. But it is worth even the investor's while to master the rudiments of the subject; for temporary causes of market fluctuations have to be allowed for. Enough has at least been said to show that the bull is a fictitious buyer, who borrows money in order to keep his purchase going, while the bear is a fictitious seller, who borrows stock in order to keep his sale going. Both have to pay commissions, either at each account or at the end of the transaction, and both either pay or receive 'differences' according as they gain or lose during each account. The student of market fluctuations is interested in the contango rate. If it is high it shows that there are a great number of bulls,

if it is low or disappears into a 'backwardation' it shows that the bears are predominant. In either event there is likely to be a change in the market as a result of profit-taking along with real sales in the one case and real purchases in the other.

But of late years another kind of speculation has become fashionable, which tends to rob Stock Exchange operators of this index to the condition and immediate future of a market. Instead of paying contango rates and commissions, a speculator may pledge securities with his bank, and with the loan so obtained will buy other securities and hold for a rise. The advantage of this method is that it avoids a commission or contango rate. The disadvantage to the mere gambler is that his speculation is limited by the amount of securities he can pledge. Moreover, the scientific operator, who wishes to benefit by foreseeing a fall as well as a rise, is helpless. If he leans on a banker's loan he can only be a bull; if he wants to sell stock short he must go to a broker and follow the method above described.

It remains to describe 'options', a favourite method with members of the Stock Exchange and one much in vogue with foreigners. There are three kinds of options:

(1) The Put. Smith contracts to pay Jones money for the right to sell him a certain security on a given date, at a named price.

(2) The Call. Smith contracts to pay Jones money for the right to buy from him a certain security on a given date, at a named price.

(3) The Put and Call, or Double Option, known in Wall Street as a 'straddle'. Under this the person who buys the option buys the right either to sell or buy the security named on a given date, at a named price. The double option usually costs double as much as the Put or the Call.

If the line between common speculative accounts and a bet or wager appears rather fine, it is almost invisible to the naked eye of an ordinary observer in the case of options, and hardly visible in the case of a double option, even to the sharp eye of judges whose lives have been given up to the making and refining of distinctions.

CHAPTER VII

WHY THE PRICES OF SECURITIES RISE AND FALL

To the economist few inquiries are more difficult or more fascinating than that which is directed to the causes of price movements. It leads him into the remotest abstractions of monetary theory, into subtle disquisitions on the delicate fabric of credit, and sometimes carries him through a maze of statistics into imaginary parallels between the recurrence of sun-spots and of commercial crises. To the business man who must always be something of a speculator—for he wants to buy for the future when things are cheap and be short of stock when they are dear—a scent for prices is of inestimable value. But he should not try to see far ahead, for he can seldom afford to take long views. He proceeds mainly by rule of thumb. The gold problem, and the silver problem, and the credit problem are to him unsolved and insoluble puzzles. Perhaps, even if he could understand the professors he would not get along very much better.

Still there are principles and rules drawn partly from experience, partly from the operations of reason and common sense, which deserve to be plainly stated even though our space is altogether too limited for any exhaustive discussion. In the first place, the prices both of commodities and securities depend upon the law of supply and

demand. If while the world's demands for woollen and worsted cloth remain unchanged the supply of sheep's wool increases, then the price of wool is bound to fall; if it decreases, then the price must rise. Again, if the supply of wool remains constant, and the demand for cloth rises or falls, the price of wool will rise or fall until an equilibrium is attained. Other things being equal, an increase of supply or a diminution of the demand lowers the price, while a decrease of the supply or an augmentation of the demand raises it. Thus when — to meet the expenses of the Boer War — our Government issued more than 150 millions of Consols and Exchequer bonds, and Treasury bills, the price of Consols fell heavily; and when the war was over, it was found that the proportion by which the National Debt had increased corresponded almost exactly with the proportion by which the price of Consols had fallen, showing that the public demand for gilt-edged securities had remained fairly constant. The fall in British Funds caused by the War of 1914–18 was heavier, but not in proportion to the enormously increased supply, showing that first-class securities are more in demand on the principle of Security First.

Again, as was indicated in the preceding chapter, a close parallelism is to be found between commodity prices and security prices when you have a security whose rate of interest depends on the profit derived from a raw material. The shares in copper mines, or tin mines, or rubber plantations are obvious cases in point. The market for the shares fluctuates freely with the selling price of the

product. It was the enormous rise in the price of rubber from 3s. to 12s. per lb. that caused the first rubber share boom; and as soon as the prices of rubber at the auctions in Mincing Lane began to fall the downward movement in rubber shares commenced. While rubber prices were at the top, rubber plantation companies were floated successfully by the hour. When the slump came the fish ceased to bite, and the company promoter turned his attention from rubber to other things. Similarly the recent slump, which has brought rubber below threepence per lb. in 1931, has made rubber growing unprofitable and rubber plantation shares almost unsaleable. Flotations of new companies in such conditions are out of the question.

Another supposed connexion between commodity prices and security prices may be noted. Except in countries with a silver standard, or in those unhappy communities which are at the mercy of an inconvertible paper currency, prices mean gold prices. Hence a great increase in the production of gold tends to reduce its purchasing power and so to raise prices, while a great diminution in the output tends to increase the purchasing power and so to lower the general level of prices. But in the case of interest-bearing securities this factor is almost negligible; for the value of the security depends primarily upon the rate of interest which it bears, and the rate of interest has no real connexion with the ratio between the quantity of gold in the world and the quantity of securities. Roughly speaking, the yield of Consols was much the same (about 3 per cent.) in 1750, in 1850, and

in 1910; but of course the output of gold and the relation between gold and securities, or gold and silver, or gold and credit were so entirely different at the three dates that no scientific mind would dream of attempting to bring these things into comparison. The fluctuations of the Bank of England's gold reserve are a barometer of the London money market, and gilt-edged securities naturally tend to fall when the short loan and discount rates rise. But the price, or purchasing power, of gold has no connexion with the price of money or credit. Money may become dearer—i.e. rates of interest may rise—in a period when the output of gold is increasing, or it may become cheaper when gold production is diminishing.

And here for the sake of clearness, in order to make quite plain what money is and what it does and why its purchasing power varies at different times in the same country, and at the same time in different countries where different standards or different tariffs are in force, we shall permit ourselves to digress a little upon the meaning of money.

Modern monetary systems may be divided into three main varieties—gold standard, silver standard and inconvertible paper. Gold-standard countries usually have a token currency of silver and copper or nickel for the convenience of retail purchases, and also currency notes issued by the authority of the State for larger amounts. If the gold standard is absolute both for internal and external purposes, as it was in England before 1914, then currency or bank-notes are absolutely and at all times

convertible into gold.[1] In France, which until 1914 retained a system aptly described as limping bimetallism, the notes of the bank of France might be met by that institution in either gold or silver, and as the silver was not worth its face value a bill on Paris could not compete with a bill on London for international purposes.

In all gold-standard countries, prices are gold prices and rise or fall with the purchasing power of gold. In China, on the other hand, which (in so far as it has any standard at all) has a silver standard,[2] prices are silver prices, and their movements are quite independent of movements in gold-standard countries. Thus in a given month the price of tea or rice may rise in Shanghai while it falls in London. This means that all the world over an ounce of silver will buy less tea or rice at the end of the month than at the beginning, and, conversely, that an ounce of gold will buy more tea or rice all the world over, at the end than at the beginning of the month. It also means that the price of silver in gold currency has fallen, while the price of gold in silver currency has risen.

The worst kind of currency is an inconvertible paper currency; even in 1910 some important

[1] Our gold bullion standard, which was established in 1925, and lasted until the autumn of 1931, did not permit the circulation of gold currency at home, but maintained a free gold market, and a gold reserve at the Bank of England, for the purpose of supporting the sterling exchange. A similar system was adopted by France in 1928, as well as by Germany, Austria and several other countries, which stabilized their depreciated paper currencies.

[2] At the end of the second World War China was in economic chaos and its paper money worthless.

countries, such as Russia and Brazil, were still on a paper basis. They endeavoured, however, by keeping a large gold reserve in a central bank, to maintain a fixed relation between gold and paper. Where no such relation was maintained, the most deplorable and fraudulent confusions resulted. During or after the first Great War many countries drifted into an inconvertible paper currency. Then stabilization began. But the collapse of prices and the scarcity of gold began to operate after the Wall Street slump, and during 1931 Great Britain and a number of other States went off the gold standard.[1]

It will be seen, then, that commercial relations between gold-using countries are comparatively simple, but that exchanges between gold and silver standard countries, or gold and paper countries, may be extremely changeful and hazardous. In such cases a speculative element enters into international transactions. It was this consideration among others that induced the British Government to close the Indian mints to the free coinage of silver in 1893, and to fix the value of the rupee so that the external trade of India with its chief customers might be simplified, and its internal prices might not suffer from the fluctuations of a metal so variable as silver had then become.

The slight variations of exchange between gold-standard countries depend upon the balance of

[1] Since then bitter experience has again proved that there is nothing so demoralizing to business as an inconvertible paper currency which fluctuates in accordance with the discretion of a corrupt or incompetent Government.

rade and indebtedness at any given time. If in order to balance indebtedness it is necessary to end gold from London to Paris or New York the xchange is said to be unfavourable to England nd vice versa. This uncertainty, it will readily be nderstood, introduces a slight element of speculaion into the arbitrage dealings between the leading ourses.

But whether it be composed of gold, or silver, or aper, money in every country of the world is the neasure of value and the medium of exchange. The price of a thing is its value as measured in the ountry's money. When the farmer exchanges his vheat for clothing and machinery, he does not arter. He first sells his wheat for money, and then ses the money to buy what he needs. The properties of good money—as the textbooks rightly leclare—are that it should be portable, coinable, livisible, indestructible, and stable in value. Portable' really means 'precious' as gold or liamonds are precious, i.e. small and costly. Coinable' means that it can easily be melted, cast nto equal sizes, and stamped with a recognizable nark. Thus gold, silver, copper are ductile and oinable. 'Divisible' means that it must not lose alue when divided. Thus two half-ounces of gold r copper are worth as much as one ounce. But if large gem is cut into small ones it may lose most f its value. 'Indestructibility' is a most important uality. The wear and tear of a gold coin is so ncredibly small that hardly any saving is effected y keeping the gold in banks and issuing gold ertificates or currency notes. The possession in so

remarkable degree of all these qualities led to the establishment of gold as the standard of value and measure of exchange in most civilized countries between 1870 and 1914, with silver as the subsidiary coin and copper or nickel as token for petty payments.

One of these properties of good money—'stability in value'—requires a few words of explanation. By what can only be described as a piece of great good fortune the value (that is to say the purchasing power) of gold during the century which intervened between Waterloo and the first Great War was extraordinarily steady. If you look at any particular commodity such as wheat, or wool, or cotton, or iron, or silver, or rubber, you will find that its price in gold fluctuates enormously from year to year, and sometimes even from month to month. But if you take twenty commodities you find that their prices hardly ever rise and fall together. Thus in the old days, when harvests were all-important, it used to be said that if wheat were cheap wool would be dear, and vice versa. For when the poor had cheap bread they could buy clothes, and so there was a greatly increased demand for wool, and wool necessarily rose in price. Of course a great diminution in the output of gold will ultimately increase its purchasing power and lower the general level of prices, whereas a great increase of the output, such as that which followed the gold discoveries in Australia in the middle, or the gold discoveries on the Rand at the end of last century, must tend to decrease the value and lower the purchasing power of gold, that is to

raise the gold prices of commodities. But just because of its indestructibility, the mass of gold in the world is so enormous in comparison with what the mines can add to it in a year that the effect of an increase or diminution in output is at first very slight; and whenever the supply is enlarged, the effect is apt to be balanced or nearly balanced either by an increase in the production of other commodities or by an enlarged demand for gold from governments which have established a gold currency, or from banks which wish to strengthen their reserves of the precious metal.

The relation between gold and credit is subtle and difficult. Many able writers maintain stoutly that gold is the basis of credit, and city men are very fond of attributing changes in the price of money, movements of securities and upheavals of credit to gold production or gold movements. But gold is by no means essential to credit. Credit exists in all civilized countries, where there is a demand for it by substantial persons, whether there is a gold standard or not. The real basis of credit is credibility. Gold cannot make credit or cure credit. Bankers may come to grief at a time when the reserves of gold are unusually large. A bank with a 25 per cent. reserve of gold against its liabilities may collapse through misuse of credit when a bank with a 5 per cent. reserve, conservatively managed, may be perfectly safe and unassailable. On the other hand, great gold discoveries and a greatly increased output of gold may cause a general rise of prices, which again

may produce a fever of speculation. And as a speculative boom causes a strain upon credit, the money markets of the world become tight and a general crisis and depression will result. Thus there may be, and at times there is, a close causal connexion between gold and credit or gold and speculation. The best-known example is perhaps to be found in the events following the gold discoveries in Australia. But this inquiry would take us too far from our path.

But whatever be the relationship of gold to the money market, the money market certainly has a far greater effect upon the prices of securities than upon the prices of commodities. For speculative buying and selling affect nearly all classes of stocks and shares; and gilt-edged securities, which can be sold at a moment's notice, are always in demand when money is unlendable in the short loan market. At such a time capitalists who lend in this market are apt to buy Consols and kindred securities, keeping them until money and discount rates rise. Thus Consols tend to rise owing to professional buying, when money is cheap, and to fall, owing to professional selling, when money becomes dearer. There was therefore a connexion between the price of Consols and the bank rate; and when the Consol market heard of a probable or actual rise in the bank rate it usually anticipated this sequence and made Consols a fraction lower. And as a general rule a rise in the bank rate (by enhancing the charges for borrowed money) acted in restraint of speculation, not only in stocks and shares, but also in grain, cotton, copper, rubber, iron, tin

and other commodities which lend themselves to speculation in futures.

But by this time a reader may be getting impatient. He may be saying, and probably is saying, to himself: 'Why cannot he come to business, and tell me why Stock Exchange prices jump up and down in such extraordinary ways without the least regard to gold, or bank rate, or any of these abstruse phenomena?' Perhaps the writer has a secret sympathy with his critic. At any rate he will bow to the wish, and give as plain an answer as he can to a plain question.

In the first place, apart altogether from the causes which affect the prices of commodities as well as the prices of securities, the value of a security depends mainly upon a quality or attribute which a bale of cotton, or a ton of coal, or a suit of clothes, does not possess. It is either actually or potentially interest-bearing. This quality is visible in a bond with coupons attached. A bond like that for example which is bought by subscribers to the sterling or dollar loan of a foreign State or Municipality will have attached to it half-yearly coupons, which can be cashed on the date when they become due in London or New York. If the interest is 6 per cent. and the coupons are half-yearly, each coupon attached to a bond for a hundred pounds will be exchangeable for three pounds less income tax. If the bond is bought for ninety pounds and is redeemable in twenty years at par, the subscriber who keeps it until maturity stands to get his principal back, with ten pounds added, if he holds the bond for twenty years. In

the meantime it will rise and fall according to the conditions, first of the Debtor's credit, secondly of the international rate of interest. Thus, while the intrinsic value of a coat or a pair of boots depends upon its warmth, durability, fit, etc., the value of a security depends mainly upon (1) the rate of interest, (2) the safety of the principal, (3) the likelihood of the principal or the rate of interest either rising or falling. The quality of a good bond is security of a fixed rate of interest and security of principal. The quality of a good share is the probability that it will rise in value, and that the rate of interest or dividend will improve. Here, then, we have the main causes of a rise or fall in securities.

But the business of Stock Exchange operators is to endeavour to forecast and discount in advance the natural fluctuations of intrinsic value. In the old days, before the telegraph, when postal communications were slow and untrustworthy, fortunes were made by getting early information, or spreading false information, of victories and defeats, which would enhance or depress the price of Government stocks. Thus the London stock-jobbers in the days of the French wars had private messengers and carrier pigeons to bring them news. In accordance with these reports, the insiders would first buy or sell the funds and then publish the report, and sell what they had bought to the public or buy from it what they had sold. The first Rothschild, or rather the founder of the house, laid the foundations of his immense fortune by getting early news of important events.

Nowadays the principle is still the same, but the art of anticipation has been made much more doubtful and complicated. Telegraphs, telephones and wireless are open to all. Every one can watch from day to day, and almost from hour to hour, the progress of wars and revolutions abroad. What everybody reads at the same time in his morning paper is of no particular use to anybody in a speculative sense. Besides, many foreign governments—especially the sturdy borrowers—keep large funds in London, New York or Paris for the express purpose of supporting the market. Hence in the market for Government bonds, except when insiders know in advance about some pending reorganization of the finances of some discredited Government, big movements are rare, and the losses or profits they cause are widely distributed. Consequently successful jobbers in the foreign market of the London Stock Exchange, and in the Consol market, live and flourish on their daily turnover rather than upon occasional speculative scoops, though no doubt their success largely depends upon their skill in acquiring a good store of stocks when they are cheap and upon being short of them when they are dear.

When we come to the prices of railway and industrial stocks the causes of movement are much more difficult to detect, and the possibility of making large profits by inside knowledge is much greater. The newspapers may be the conscious or unconscious tools of the manipulators. In new countries the banks are apt to be a working part of the speculative machinery. Thus in the United

States those who use great fortunes in finance frequently have a controlling interest in a bank, or even in a chain of banks. What is called 'a community of interests' may be established which will control perhaps important railroads and huge industrial corporations, as well as a number of banks and trust companies. The various ways in which such a 'community' may manipulate a susceptible market like Wall Street might be made the subject of a long and fascinating volume. Suppose that a powerful group wishes to create the appearance, and even temporarily the reality, of a general trade depression in the United States, or at least to exaggerate a depression which actually exists. This is not at all impossible. The controlled railways may ostentatiously proclaim an addition to the number of idle cars. Banks may suddenly become ultra conservative; the open accounts and credits of small speculative customers may be closed. In this way a general feeling of despondency can be created. Stocks will fall, partly in consequence of the action of the banks causing a compulsory liquidation of speculative accounts, partly through the voluntary action of speculators and speculative investors who think that trade, earnings, profits and dividends are likely to decline. Thus a bear market is created. The syndicate or pool or community of interests can now employ huge funds to advantage in profitable purchases of those stocks and shares which fall most and are most responsive to ups and downs of trade. Such a policy of course involves difficulties and dangers. It must be carried out cautiously and secretly, and

honourably as between the members. Leakages are disastrous. And if it is too successful it may create a slump, or a panic, leading to widespread ruin in which the community of interests may itself be seriously involved. For these and other technical reasons, touched upon in our chapter on Wall Street, the great American operators and manipulators do not very frequently enter upon a concerted plan for colossal bear operations. Such a course is unpopular. It offends public sentiment. Rapid ups and downs of stocks and shares give a general and pleasurable excitement, appealing to the speculative nature and traditions of the people. But a long bearish movement, accompanied by unemployment, short time, reduced earnings and profits and general economies in the style of living and expenditure, produces or may produce all manner of unpleasant consequences — economic, social and political. In fact, there is a sort of moral sentiment against bearish operations on a grand scale, which makes Wall Street (the greatest financial manipulator in the world) the home of the bull who tosses securities up rather than of the bear who tears them down. Big men—the so-called giants—often boast that they never operate on the short side, never play for a fall.

The sketch 'bear' operation of a great community of interests, which has been outlined above, is therefore comparatively rare, cautious and temporary. Wall Street has of course to wait upon circumstances. Sometimes it is caught by circumstances. But whether circumstances hurt or hinder, it must always try to adjust itself to economic and

political conditions. A political assassination, a war, a movement against the trusts, unfavourable decisions in the courts, an unexpected downfall of the favourite party, a catastrophe like the San Francisco or Japanese earthquakes—such events as these may produce an unforeseen flood of liquidation against which the strongest combination of bankers and corporation men will struggle in vain. In a general scramble produced by some unexpected event insiders and outsiders are for once on a par. But in such cases there is more likely to be a general loss than a general profit. For in the history of speculation the unsuspected and unexpected event is usually a calamity. Real prosperity is built up gradually. The Stock Exchange anticipates and exaggerates it, until the speculative fabric has been reared so high above the real foundation that a decline, which may become a crash, is seen to be inevitable. Generally speaking, with their superior knowledge of banking and trade conditions, the insiders are able to unload at high levels just as they have been able to load at low levels. We may draw from American experience this general conclusion, that by speculating in stocks of a national size and significance the outside public loses far more than it gains. It begins to buy when they are dear, and it begins to sell when they are cheap. It knows nothing of 'rigs', 'corners', 'pools', and 'communities of interest', until long after they are dissolved.

For the purposes of scientific analysis we may rest our theory of Stock Exchange quotations upon a distinction between prices and values. Prices are

temporary; they shift rapidly; values are intrinsic; they move slowly. The price represents the momentary market view of a stock or bond—what you can get for it on the exchange if you instruct your broker to sell. The value is the real worth—a thing undefinable and impossible to ascertain. If the real value were ascertainable and available to the public, then price and value would be identical, and in the case of gilt-edged securities we may say that price and value are as nearly as possible identical.[1] For intrinsic values do change, like everything else in this world. They may be said, in the case of bonds and preference stocks, to depend mainly upon—

1. The rate of interest.
2. The margin of surplus earning power, or revenue.

In the case of a bond there is also, first, the quality of the security pledged as guarantee of the principal, and, second, the date of maturity or redemption. The first may change, as land, buildings, machinery, etc., change in value. The second is always changing, getting nearer day by day.

Both stocks and bonds are, of course, also affected in their intrinsic value by the money market and by the relationship of the supply of capital seeking investment to the demand for capital by new flotations. When the new demand exceeds the supply of new money, capital is withdrawn from

[1] But there are no gilt-edged securities in a country which has neither a stable currency nor security.

old issues, and values tend to fall. The intrinsic value of common stock depends also in a supreme degree upon the actual efficiency of the corporation or company, the condition of its plant, the skill of its management, and the contentment, intelligence and industry of its whole staff.

Of course, all these changeful elements of intrinsic value enter into prices. But as prices sometimes fluctuate violently from day to day, and even from hour to hour, it is obvious that they must also be affected by other causes. What these are, or may be, the reader will now be able to supply for himself. But they may be summed up under one or two heads:—

1. False rumours, which have got about either by design or through the carelessness and mistakes of newsmongers. Very often a depressing rumour is merely a gross exaggeration of some tiny bit of comparatively trifling truth.
2. Rigs, pools, combinations and other technical devices by which the market is either flooded with, or made bare of, a particular stock or groups of stock.

A competent, and by no means unfriendly, observer of Wall Street, where manipulation is a fine art, thus describes the class of professional speculators 'who make the stock market their life study and business'.

These men base their operations, or try to, on values as measured by income; but they study value so as to be able to buy at less than value, and then they work to

sell at as much more than value as they can get. They employ every means in their power to make stocks attractive to investors and other possible buyers when they are 'long' and want to sell, or to make the market appear doubtful or dangerous when they are 'short' and want to buy.

This may help the outsider to realize why 'for days, weeks, and sometimes for months', prices may represent manipulation rather than intrinsic value. This may also help him to see why a clever man, who really wants to speculate with any probability of success, must become a member of a great Stock Exchange or enter a community of financial interests. It is safe to invest, but it is utterly unsafe to speculate, on intrinsic values. The insider who spends his life in watching and manipulating prices is often a very poor investor, a very poor judge of intrinsic values. The outsider surveying the world's politics and finance and commerce with a calm and unimpassioned judgement may be, and probably is, an excellent investor; but if he attempts to guess at prices by the day and the week without inside knowledge he is sure to come to grief.

CHAPTER VIII

THE CREATION OF NEW DEBT AND CAPITAL ISSUES

FOR many reasons a good citizen, as well as a good investor, should take some trouble to understand the methods by which governments and municipalities and companies borrow, or obtain new capital. Any capable critic of public finance is, or may be, a useful and influential member of society. The investor who can see through prospectuses and balance-sheets for himself is in a strong position; for both are protected by an atmosphere of advertisement from the great majority of newspaper critics. The city journalist is seldom allowed a free hand. It is a bad policy for both parties. The reader of a city page wants neither puff nor blackmail, but honest, discriminating, responsible criticism; and if he does not get it he may either drop the newspaper or drop the idea of subscribing for the issue. What he usually finds in his newspaper, when a prospectus is advertised, is a colourless summary; and sometimes the prospectus is preceded a few days before by some article, apparently spontaneous, but really paid for, descanting upon the wonderful resources of the region which the new company is going to exploit, or the extraordinary profits likely to be derived, by the lucky person who invests, from the very thing on which the prospectus is going to found its appeal. Impecunious foreign govern-

ments and municipalities often condescend to bait the ground beforehand with carefully prepared statistics of their prosperity. The beggar's rags excite charity, but the investor's purse is not opened by pity. When a country is on the verge of a new loan it is apt to appear before its creditors in very fine raiment. Boasting precedes borrowing. This, of course, does not apply to first-class countries, whose debts are gilt-edged securities. They merely issue statements of what money they want, and leave the public to apply to the issuing house or banking syndicate which has undertaken the floating of the loan. This is often a favourable opportunity of securing an absolutely good security. You get your inscribed stock or bond-to-bearer for yourself without brokerage fees, and it may very likely go to a premium, as a government or local authority frequently issues at something well below the market price for fear that the loan should prove unsuccessful and so injure the prestige of the administration. Similar considerations apply to good colonial government securities, and also, perhaps, to the loans of countries of the second rank, so long as the investor is reasonably well informed about their debts and prospects as well as about the technical features of the new loan. Hence there is a very large class of new issues to which, in my judgement, the following sweeping statement by a very able financial critic is not at all applicable:

> We arrive inevitably at the conclusion that any investor, who has no special knowledge to work on, commits a very serious indiscretion by subscribing for any new issue on his own judgement, based on a perusal of the

prospectus, and without the counsel and advice of his stockbroker. It cannot be too early grasped by any one who is in a position to invest money that the judicious investor is the investor who rejoices in a good broker, trusts him, and takes his advice.

Agreed that the beginning of wisdom in investment is to contract a business friendship with a good broker, who must of course be a member of the London Stock Exchange, or of some good provincial Exchange, it does not follow that the end of wisdom is to trust him blindly, unless, indeed, the broker is abnormally wise and the client abnormally foolish. A person of reasonable aptitude and shrewdness, who can give, say, one per cent. of his business time to looking after his savings, ought to be able to form an opinion of his own; and so long as he contents himself with good securities he will probably do best by subscribing from time to time for suitable issues of government and other stocks.[1] When securities are cheap, and nothing new offers, you may, if you have no broker, instruct the branch manager of your bank, who instructs his London broker, to buy any security you want. There is no loss in so doing, as it is the practice of the London Stock Exchange brokers to divide their commission with the bank from which they receive instructions. But the advice of Mr. Hartley Withers, which I have quoted and criticized, is sound enough if we limit it to the ordinary company prospectus. These, as he says, 'should be scanned in a spirit of jaundiced criticism, and with the most pessimistic readiness to believe

[1] Or it may be that he will do better still by buying a house or a farm.

that they are speciously alluring traps laid by some designing financier to relieve the reader of some of his money'. In such cases the advice of an expert, or better still, of two, will probably save you from loss; for even the shrewdest and most enlightened persons are sometimes caught by the glittering bait of a prospectus which would never have been issued to the public had it really been the profitable certainty it professes to be.

And here we come to a very important consideration too often left out of account in discussions of capital issues. I mean that in Great Britain, at all events, there is never any difficulty in raising capital locally or privately for the creation or extension of any business which offers a reasonable probability of large profits. A really good thing from Glasgow, or Yorkshire, or Lancashire, or the Midlands, seldom comes to London to be floated on the public. The insiders naturally keep it to themselves and their friends. Often, indeed, a successful manufacturer or merchant, who has built up his business and wishes to retire, may think that he will get the biggest price for the goodwill by turning the concern into a limited liability company. But what is good for him may be very bad for the public. They are invited, perhaps, to overcapitalize the concern. The vendor, after selling his business to the company, may remain as managing director, but his interest is no longer so keen. He is as rich as any one could need to be whatever the fate of the company. He sold at the zenith of his fortunes, and the investing public, buying, as usual, at the top, this time by subscription, sees the profits declining year by year

from the average profits upon which the prospectus was based. In many of these cases the debentures are a fairly good security, especially if they are well protected by real assets. They are also protected by English law; for companies of this description are usually incorporated under the Acts which govern Limited Liability Companies in Great Britain. Foreign and colonial companies, which raise capital in England and register abroad, are not under our Companies Acts. The laws under which they register are not always framed to protect shareholders, and in any case the situation of English shareholders who seek justice from a foreign or colonial court is often unenviable. Besides, such a company may be seriously injured by unfair if not confiscatory legislation, of which there have been instances in Canada and Australia, to say nothing of South American republics.

But a very large part of our capital exports has gone into companies like Argentine railways, Ceylon tea, Persian oil, Malay rubber plantations and the like, which are duly registered in London; and as the most profitable enterprises at home are never open to public subscription it would be absurd to advise investors who have a taste for industrial and commercial ventures to avoid all foreign and colonial prospectuses.

For obviously in new countries like Argentina, or old but unexploited countries like China, where capital is very scarce, capital has to be attracted by the offer of favourable terms. Too often, no doubt, the difference between what the lender gives and what the creditor gets is monstrously large. One has heard of a corrupt South American

Government which sought for money in London and got it *apparently* at 6 per cent.; for the loan was a 6 per cent. loan issued to the public at par, or thereabouts. But the issuing house bought the loan at 75 per cent., and after the various representatives, negotiators and officials had handled it, the purposes for which the loan was nominally floated probably did not receive more than 50 per cent. of the sums so greedily supplied by our simple and gullible public. Is it surprising that a loan like this, nominally at 6, really at 12, per cent., proves unreproductive, that the impecunious province or municipality after a year or two fails to pay the interest, that there is a grave scandal, and eventually a composition by which the investors lose perhaps half their subscriptions?

Much might be said—were there room for such a digression—on the economic significance of our capital exports. But that the vast importance of this subject may be appreciated we shall here set out in detail the *Economist*'s tables of London's public issues of capital for 1910 and 1930. In the former year—as a result partly of great prosperity, partly of general buoyancy and speculative activity, partly of the extraordinary boom in rubber plantations—an amazing record was established over any previous figures. It will be seen that, ten years after the war, London's issues of new capital came to the same total as twenty years before. The war had intervened, and the surplus savings of the country, measured by sterling, showed no improvement, though in the previous period they had risen enormously.

As might have been supposed, the enormously

ANALYSIS OF NEW CAPITAL APPLICATIONS

Description.	Total 1910.	Total 1930.
	£	£
British Government loans .	24,595,000	65,640,000
Colonial ,, .	35,631,000	49,081,300
Foreign ,, .	18,431,000	21,330,000
British Municipal and County loans	1,627,900	41,657,600
Colonial Corporations . .	4,308,500	3,001,500
Foreign ,, . .	7,119,400	*Nil*
British railways . . .	3,715,000	16,119,500
Indian and Colonial railways .	10,096,000	2,875,600
Foreign railways . . .	49,974,700	7,615,000
Mining Companies—		
Australian	562,400	257,800
South African . . .	2,595,700	493,500
Other mines . . .	4,234,500	4,597,500
Exploration and financial .	18,343,100	6,316,000
Breweries and distilleries .	675,000	2,078,500
Merchants, importers and exporters . . .	250,000	*Nil*
Manufacturing . . .	5,086,300	[included in Miscellaneous]
Stores and trading . .	320,400	3,220,300
Estate and land . . .	5,169,900	445,400
Rubber.	19,143,800	1,160,000
Oil	9,466,400	8,050,000
Iron, coal, steel, and engineering	5,409,300	1,285,000
Electric lighting, power, telegraphs, etc. . . .	6,160,000	3,728,400
Tramways and omnibus .	4,701,000	*Nil*
Motor traction and manufacturing	368,500	681,600
Gas and water . . .	131,700	3,393,300
Hotels, theatres, and entertainments . . .	1,503,700	20,000
Patents and proprietary articles	1,313,200	367,500
Docks, harbours, and shipping	4,600,000	*Nil*
Banks and insurance . .	10,789,000	3,023,600
Miscellaneous . . .	11,116,100	21,361,700
	267,439,100	267,800,700

increased cost of central and local government is reflected in an increase of public borrowing. The capital raised in 1910 was for more productive and useful purposes than the issues of 1930.[1]

The promotion of a new company in London has been described with veracious vivacity by Mr. Hartley Withers, in his book on *Stocks and Shares*; the problems and operations of American promoters in the flotation of new undertakings and the combining of old ones into new trusts and corporations have been expounded critically and exhaustively by Edward S. Meade, in his clever study of *Corporation Finance*. In new countries like Canada, Argentina, or Australia, and in countries like the United States which are still filling up and present ever fresh openings for the profitable employment of new capital, the promoter plays an ill-important part in economic developments. The function has been so much abused that the name is in evil odour. But an honest promoter, with a good eye for a good opening and the skill and credit to utilize his opportunity, is really a public benefactor and deserves to be well rewarded. If he is unscrupulous, floats bad propositions, and takes more than his share, he is a public nuisance, and probably in the long run will suffer the rogue's fate. For, happily, honesty is the best policy; and it pays particularly well in walks where dishonesty is particularly prevalent.

From the standpoint of general utility there is all the difference between the promoter of a real new enterprise and the promoter of a combination

[1] Since the second World War broke out in 1939 the national debt has risen from 8 to 24 thousand millions and all the liquid capital has been mopped up by the Government.

or amalgamation. The former is calculated to increase wealth; the latter is rather likely to diminish it. The former is good for employment, the latter is likely to reduce it. The former increases the good things of the world and multiplies the conveniences of life. The latter aims at restricting them and so increasing their cost. One is addition, the other subtraction. One enlarges the world's resources and enriches the consumer by giving him something new; the other exploits him by establishing a monopoly and so forcing him to pay higher prices or to pay the old prices for inferior articles. The idea that union means strength and that great size means great profits in industrial combinations has been circulated and believed for a generation. In recent years, many large concerns have been floated under the banner of rationalization, with plausible promises of resultant economies. But there are signs that the cult of rationalization is dying of disappointment in 1931.

A strict combination of all the manufacturing concerns in a protective country may, however, enable them to extract every possible penny of the protective duty out of the consumers. That they should unite for this purpose is the most natural and certain thing in the world, and to attain the end a promotor is often needed. The reason why they so often have to go to Wall Street, or to some similar financial centre, is that they cannot all agree how the capital shall be watered and how the shares shall be subdivided. Very often, indeed, the scheme or proposition is made by a promoter, and the individual manufacturers are induced to come in by tempting offers, or threats of ruin if they stay

out. From the investor's point of view, the history of these unions, associations, trusts, or combinations has been generally disappointing. Many of them are waterlogged from the outset. In a free-trade country they cannot raise prices on account of foreign competition. In a protected country prices have already been raised, and what they gain by raising them higher they may lose by diminished consumption. The keenness and energy of the individual employer is sapped by centralization. Much is often wasted at the outset by buying worthless mills with antiquated plant, merely to close them down. Then other independents crop up who have also to be bought at excessive prices if there are funds for the purpose.

The absolute or relative failure of nearly all the English combines which have been floated on the market is too well known to be insisted upon. A superman with a huge salary usually steers them into insolvency; and then another superman is appointed to 'rationalize' them for a new voyage. In the United States the idea of converting every branch of industry into a single trust—a consolidation of all competing plants—with a view to extracting monopoly profits has been carried further than anywhere else. Under the shelter of the tariff huge concerns have grown up; by the zeal of the promoter they have been enlarged into million and billion dollar trusts. In a sense, all the competitors are promoters, and in this sense the transaction has usually been very profitable; for the watering of capital merely means that the promoters have received from the public far more money than the consolidated concerns are worth. In some

celebrated cases, after a series of years in which the common stock has received no dividends and the preferential shareholders have been only irregularly paid, a good deal of water has been squeezed out and fortunes have been made by large operators who bought stock in years of depression. But I am inclined to think that if all the industrial combinations promoted and marketed in the United States and listed in New York or other American Stock Exchanges could be examined historically from the standpoint of the original investors and subscribers (leaving out those who received some part of the promotion profits in stock) the record would prove disappointing.

The promoter who is consolidating competitive interests into a trust or association may appeal for support on various grounds:

1. Competition will be eliminated and so prices can be raised and controlled. In times of depression prices can be maintained by curtailing output and closing factories.
2. A centralized management can effect the economies that belong to large operations. Superfluous persons can be dismissed regardless of local claims.
3. The size of the concern should enable it to get very favourable terms from railways and from producers. A large buyer can afford also to deal sternly with small customers who seek to cancel orders or 'readjust contracts' when trade becomes bad.
4. A large combination is in a better position to resist the demands of organized labour.

All these propositions are plausible, but all contain a mixture of truth and error. To the last one, for instance, it may be urged that just as it is easier to deal with organized labour than with undisciplined labour, so labour leaders can extract terms more easily from the executive of a federation than from individual employers. Moreover, if a combination in restraint of trade deals harshly with labour it becomes unpopular and may become the object of legislative or administrative attack. The economy of large operations is often more than offset by central mismanagement. The directors of a big trust may be directors of banks and many other concerns, as in Germany. Their income may be derived mainly from financial operations. Their interest in, and the time they can spare to, the trust may be, and probably is, very small. In any case, half a dozen men sitting in a central office and issuing orders to local factories of which they have no practical experience are usually a poor substitute for the individual manager who has made the business by his own exertions and is now enjoying the capital sum for which he has exchanged his concern. The ingenuity of the corporation lawyer who frames the trust will overcome all the technical difficulties, but it is generally found that a great concern cannot be fairly capitalized. The proper basis for determining the value of all the plants together would be the earning power of each individual plant averaged over a series of years. But a little reflection will show that when it comes to capitalization all will expect to get more than their concerns are really worth, and all will succeed in various degrees. After the War of 1914 many

of the unprofitable cotton mills in Lancashire were 'rationalized'. But a conglomeration of small failures, even bought at low prices, is seldom a success.

Very often the trust promoter is forced to 'fight for his own hand', as one of them expressed it, throughout a long and complicated course of diplomacy, associating with the stronger members of the trade and squeezing others. He has to keep his eye, of course, on the public, and in most cases, as Meade puts it, his business is 'to buy plants from their owners at one price and sell them to the investor at a higher price'. When, by alliance, persuasion, and coercion, the promoter has 'assembled his proposition', he will approach bankers. In important cases a syndicate will be formed and a financial plan devised, consisting usually of bonds, preference and common stock. In the case of a consolidation, bonds are usually issued in part payment to the individual concerns. Thus, when the Steel Trust was floated by J. P. Morgan, Carnegie and his associates were in such a commanding position that they were able to demand successfully no less than three hundred million dollars of first mortgage bonds. Preference stocks also play an important part in large industrial issues.

When a company is floated to develop some new traffic or industry, the promoter is often an engineer with banking connexions. The promoting engineer is defined by Meade as 'a firm or corporation engaged in the business of building trolley roads, power plants, railroads; doing all kinds of engineering and construction work within a certain field'. Such firms, especially in London and other great money centres, will often have a large capital as

well as a big credit. They will possess a skilled organization of electrical and other engineers, chemists, lawyers, and accountants. British, German, and French engineering and promoting firms of this type are prepared to undertake contracts and promote enterprises in all parts of the world. There are great advantages in an engineering contractor being associated with and interested in the success of a great engineering enterprise. But it is not desirable that after the company has been formed it should be controlled by its contractor, because the contractor is always interested in construction. If, for example, the dominating interest in a railroad company is the contractor, he is apt to be always extending the line or electrifying it, regardless of shareholders' interests, in order to provide his own firm with work.

Small flotations usually originate with local men, especially landowners who desire to sell their land on favourable terms for coal, oil, or similar propositions.

Among the preparations made for the floating of a new company, or for an issue of new capital by an old one, none is more important than the underwriting of shares. In few cases can a promoter afford to appeal to the public until the sale of his wares has been thus guaranteed. By acting as underwriters for new issues, City capitalists often make very large profits, though from time to time, when the public fails to bite, they stand to lose. Thus when a new issue is unsuccessful, or partially unsuccessful, it is announced that the underwriters have been left with, say, 75 per cent. on their hands. A few years ago the underwriters in ordinary cases merely engaged to take any shares

which might not be subscribed by the public, so that such a result would have been thought very disappointing. But now it is becoming more and more common for the issuers to stipulate that the underwriters shall actually purchase at the price named whatever quantity of shares they may have underwritten; so that, whereas the old form of an underwriting contract merely obliged the underwriters to take a fixed amount or a fixed proportion *conditionally*, the new form obliges them to take it *absolutely*. In other words, there is a 'firm', as distinct from a hypothetical undertaking. The underwriters are allotted their shares and actually receive them. But whether they underwrite 'firm' or no, the vast majority of Stock Exchange men who engage in this business buy the new issue for the purpose of selling it at a profit. And this they can usually do, if it is at all promising; for even if, after the stock is issued, it stands at a discount of 2 per cent., yet, if it has been underwritten at a discount of 5 per cent., an underwriting broker or banker can still dispose of it gradually on very satisfactory terms.

But besides the underwriters who underwrite in order to sell as quickly as possible—the speculative underwriters—there is also now a very large and important class of underwriters who underwrite good securities with a view to holding them as investments. Conspicuous among these are the insurance companies and investment companies or Trusts, which have grown to be very great and important factors in the capital and investment market. For short dated issues, such as the short term notes with which London is often flooded by

American railroads and industrial corporations, and even by American cities, the banks compete with the insurance companies. These short term notes 'mature'—i.e. are repaid—at various dates, and an insurance company often likes to have a security of this sort, which will pay good interest and mature, or fall due, in a year when an extra amount of revenue will be required for bonuses. Banks, again, when money is cheap and plentiful, find that by purchasing such notes they can get a run of comparatively high interest for a few months. But an insurance company does not need to keep its capital liquid in the same way as a bank. It is a great investor. In fact, in the case of the biggest companies the investment department is becoming as important as the insurance department. By underwriting good issues an insurance manager does better, as a rule, than by buying securities in the open market; for in this way he gets them well below the market price. That part of a new issue, therefore, which is bought by an insurance company is taken permanently off the market and stowed away. And it will be held firmly for the sake of the interest, without much regard to its price fluctuations, for an indefinite period, unless (as sometimes happens) some great disaster like the San Francisco earthquake forces a company to realize part of its holdings. Hence it often happens that, when a new issue has to be taken very largely by the underwriters, it is better placed and more firmly held than when it is over-subscribed by the public; for the outsiders who subscribe for new issues are often 'stags', who apply for far more than they could really buy in the hope of

being able to sell shortly afterwards at a premium. In that case the premium rapidly runs off under a fire of sales, and the stock may stand for a long time at a discount.

There is, of course, a vast difference between good underwriters and bad ones. During the rubber and oil boom, in the early months of 1910, there was a rush of popular issues—many of which afterwards proved to be bubble companies. In that case, as Mr. Withers once pointed out, underwriting is 'a simple and easy method of putting a nice cheque into one's pocket by merely undertaking to do something which one is most unlikely to be asked to do'. Most interesting stories, he added, are told of profits so made and of resultant banquets by more or less impecunious gentlemen in the West End, who, having a sort of semi-connexion with the City, acquired the privilege of underwriting, on generous terms, blocks of shares in rubber or oil companies for which they could not possibly have paid had they been called upon to do so. 'This sort of underwriter is merely an impudent fraud, like anybody else who takes money in return for a promise that he could not keep. Luckily, he can only make his appearance when the public is demented by one of its periodical speculative manias.' Weak underwriters of this class are often caught, especially towards the end of a boom when the public is glutted. Many poor City clerks, as well as smart West Enders, were left at the end of the rubber boom with quantities of unsaleable scrip, liable to heavy calls which they could not meet. A respectable new venture will never make underwriting arrangements of this sort. It may

perhaps be legitimate, where the risk is high, for the underwriters' commission to run up to 10 per cent.; but where it runs up to 25 per cent. the subscribing public is obviously being swindled. In any case, companies floated on these terms are bound to be overcapitalized; i.e. the capital on which they are to earn and pay dividends is excessive, and, consequently, investors who subscribe to the issue are almost sure to be disappointed. Further, whenever the underwriting arrangements, made behind the scenes, do not ensure that the shares underwritten can be taken up and paid for —in short, whenever the underwriters are not men of substance and credit—the subscribing public is shamefully wronged. It would be greatly to the advantage of the City if these scandals could be made impossible by legislation.[1]

There are, therefore, two distinct types of underwriters shading off into one another:—(1) The speculative underwriter, who underwrites to sell; and (2) the investing underwriter, who underwrites as a real purchaser, to obtain and hold securities. Both kinds do the work for a commission by means of which they obtain the shares at anything from 1 to 25 per cent. (or even more) below the nominal price. The solid underwriter is of course mainly concerned with good public loans, home, foreign, and colonial, or bond issues of railways and industrial companies, whereon the commission or discount is not very large. During the industrial boom of 1928, many small new companies were floated in London. On

[1] Since 1931, I am told, Stock Exchange scrutiny has been closer and scandals correspondingly rare.

17 August 1929 the *Economist* examined the fate of 128 of these concerns. Their total par value was over thirty millions; their market value at the time was only £17,400,000; so that the original subscribers, who had bought their shares at par, had already lost over 42 per cent. of their money. This was just before the Wall Street slump, which doubtless swept away most of the remainder.

It is generally provided in the prospectus of a new issue, whether by a public authority or by a private company, that a subscriber shall pay by instalments spread over several months. This method, which is now practically universal, was introduced by the British Government during the eighteenth century, and in some cases a system of underwriting was adopted in those early days of public borrowing either in order to enrich favoured individuals or for the legitimate purpose of ensuring success. In the tenth edition of Mortimer's *Every Man his own Broker*, issued in 1775, the system then in vogue is described as follows:—

When the Parliament has voted these supplies, and resolved on the ways and means of raising them, a subscription is set on foot, and is either open to the public, in which case every responsible person is at liberty to apply, by a proper letter to the right honourable the Lords Commissioners of the Treasury, for leave to be admitted to be a contributor, naming in his letter the sum he desires to contribute; or else it is private, that is to say, a certain number of persons of fortune have agreed to be answerable for the whole sum to be subscribed; and have made the required deposit. In this case, the only step to be taken, by those who are not of the number just mentioned, is to apply to them for such part of the subscription as you want, which if you are a

particular friend, they will, perhaps, spare you without any premium, or for a very small one; for it is not be to presumed, that any inconsiderable number of men, who have subscribed for the whole sum to be raised, intend, or can keep it, but that they propose to include in their subscription, all their friends and acquaintances. Sometimes the subscription lies open to the public at the bank or at the Exchequer, and then every person is allowed to subscribe what he thinks proper; and if, upon casting up the whole, there is a surplus subscribed, as has generally been the case, the sum each subscriber has subscribed is reduced in a just proportion, so as to make in the whole, the sum granted by Parliament.

As soon as conveniently may be, after the subscription is closed, receipts are made out, and delivered to the subscribers, for the several sums by them subscribed. . . . The first deposit is generally of fifteen per cent., and is made on or about the time of subscribing; the second is about a month after, and so on till the whole is paid in, which is generally in October; each monthly payment being either ten or fifteen per cent. Those, who chuse to pay the whole sum before the appointed day of payment, are allowed three per cent. from the time of such payment to October. The subscription receipts thus paid in full, are called in the Alley, Heavy-Horse, because the gentlemen of the Alley can make greater advantage than *three per cent.* by the Light-Horse, and therefore they will not give so good a price for the Heavy; nay, some of them will have absolutely nothing to do with it, for this reason, that they can buy a thousand pound, Light-Horse (with one payment made) for the same money as one hundred pounds Heavy, and by buying for the Light, they have an opportunity of sporting with, and gaining a profit on, a nominal thousand, for the same money that it would cost to buy an hundred Heavy. Light-Horse, therefore, is the commodity to jobb with.

The advantage of 'Light-Horse' to speculators, of course, was that a small amount of cash would buy a large amount of paper value. After the first payment, for example, a person could buy for £75 a receipt for £500 scrip, and for much less if, according to custom, the value of the lottery ticket were deducted. No doubt, many purchasers of Light-Horse were persons of small capital who bought for the rise and were anxious to sell or get out as soon as possible. When a cheap and tempting prospectus appears nowadays it is always oversubscribed in the same way by small operators who sell out the moment a good premium is established. But sometimes they are disappointed. The issue does not go to a premium. In that case, writes Mortimer, the disappointed gambler in Light-Horse scrip 'may put it out to nurse, that is, deposit it in the hands of some moneyed man, who for a proper consideration will pay upon it and keep it as his security till the proprietor has an opportunity of selling it to advantage'.

Those acquainted with the problems of modern banking, and the competition between commerce and the Stock Exchange for accommodation, will be interested to know that 170 years ago 'a branch of business perhaps as considerable as any amongst the bankers near the Alley' was the taking in of various kinds of paper, such as scrip, long annuities, etc., in pawn. At one time, indeed, the pawning of scrip became so large and profitable a business that the bankers and bill brokers of Lombard Street 'openly refused to discount bills, to the great detriment of the commercial interest'.

CHAPTER IX

CAUTIONS AND PRECAUTIONS

In the preceding chapters Stock Exchange securities have been discussed principally from the standpoints of London and New York. In some respects Paris and Berlin are equally interesting, especially in their banking ramifications and in the alliance —dangerous to both—which public diplomacy has contracted with high finance. But if the financial panorama of the old world and the new had to be studied from two centres only, there is no doubt that Lombard Street and Wall Street should be chosen. The city of London, with all its vast and delicate financial organization clustering round the Bank and the Stock Exchange and Lloyds, directing, controlling, guiding, or influencing rates of interest and discount, rates of exchange and rates of insurance in all parts of the world, is unique as a market for commodities, a market for stocks, and a market for capital. Here all these things are bought and sold on an international scale. It would be a mistake to say that London is not speculative. But there is so much old wealth, such long traditions of caution and stability, so keen a sense of responsibility among those in command of the leading banks and houses, that London, with its unequalled annual surplus or overflow of capital for export, should be reckoned rather as the capital city of banking and investment than as the chosen home of speculation. That second title belongs of right to

New York. Its Stock Exchange list is reprinted hourly by the tape machine from New Orleans to San Francisco, and from San Francisco to Montreal. Over 120 millions of people vibrate to the palpitations of Wall Street. This ferment of speculation over so vast a continent has its good and its evil sides. At times it becomes an international danger, and ends in a panic which sweeps away thousands of apparently flourishing concerns, and scatters gloom over the trade and securities of the whole world. But the rapid development of material resources, mining, agriculture, manufactures, transportation, is of necessity associated with speculation. For speculation in the best sense is the investment of capital and the use of credit to finance enterprises which promise to yield handsome profits. But for an evergreen faith, salted with the love of risk and adventure for their own sakes, how could mountains be bored and waters bridged? If there were no bad speculations there would be no good investments, if there were no wild ventures there would be no brilliantly successful enterprises. New York, then, must be valued fairly, not as a sort of gambling hell, but as a nerve centre of American enterprise. It is the ultimate court of high finance before which nearly all important local propositions for large enterprises throughout the States of the Union, and often far beyond its northern and southern boundaries, must come cap in hand.

Nevertheless, those cautions and precautions which it has been our purpose to throw in the path of rash investment, are by no means to be slighted merely because material enterprise, en-

riching the world and spreading the comforts of civilization through hitherto inhospitable and barren regions, is necessarily based upon the credit provided by the banker and the money provided by the speculator. Those who have saved money by their own enterprise and thrift are fools if they lend it readily on promises of romantic profits in distant regions. Providence bids us remember that if an enterprise is really very promising, money will be found somehow locally, by those who have seen it with their own eyes. When doubtful propositions have to be floated the promoters always calculate that distance will lend enchantment to the view. They try to raise their money among people who can only read their prospectus.

Of course there are not many hard and fast rules in business life; but there are some in connexion with investment with which the reader of these pages will have become acquainted. In recapitulating some of them we may be able to add a few further hints.

First of all, an investor may of course be well advised to insure himself against death, sickness, fire, burglary, etc., so reducing that annual surplus which would otherwise be available for investment proper. Then, secondly, he may use another part of his surplus to buy his own house by instalments. Often, though not always, he may thus make a very high rate of interest on his money; and if in the neighbourhood in which he lives rents are tending to rise year by year, he may look not only for a high rate of interest but for an appreciation of his principal. But when he comes to the purchase of a

Stock Exchange security he should be careful, in the first place, to buy it from a respectable quarter, i.e. from an official broker of a good Stock Exchange, or from a respectable banker, who acts as an intermediary. Any one who is in the happy position of being able to invest frequently should certainly be in touch with a good broker, or better still, with two, if etiquette does not stand in the way. He may very well ask his broker to send a short list of securities of various types and yields to compare with his own list. The advertisements and circulars which come by post from unauthorized brokers and bucket shops (often with some grand title to suggest that they are 'investment' companies or 'bankers') should be treated with as little respect as a German invitation to a lottery. Sometimes these companies have the impudence to ask you for a list of your investments, and to promise you that if you will take their advice they will be able to exchange them for equally good securities which will yield you one or two per cent. more. And they will charge you no commission!

This is very kind indeed, and many simple folk respond to their appeal. Probably the so-called 'bank' or 'investment' company has bought a lot of rubbish, usually called 'bonds', from shaky industrial concerns, or from half-bankrupt states and municipalities of South America. They have bought, let us say, the 6 per cent. bonds of the Yoko Silk Company in Japan at 60, which they sell you at 90, the 5 per cent. bonds of the Brazilian Province of —— at 55, which they sell you at 75, and a few other similar bargains. They tell you

that if you then spread your risks scientifically over different countries you will be perfectly safe. You perhaps do not realize that none of these securities which you are advised to buy are quoted on the London Stock Exchange. If they were, the game would be impossible. As it is, you cannot know what your philanthropic company actually gave for them, and if asked they explain that officially quoted stocks never go so cheap as those they are able to offer you. Some time after you have been gulled you may be forced to sell one of these bargains, and then, if your company is still in existence, it will tell you that all the stocks you bought from them have fallen heavily in price, or at least that they are not immediately saleable. They will perhaps promise to make inquiries and try to find a purchaser. Your best hope then is, by threatening them with exposure, to force them to pass on the rubbish they have sold you to some equally foolish and inexperienced person. That is not a pleasant thought. But if you can persuade a bucket shop to buy its wares back at any sort of price, you may be sure it will not keep them in its larder.

The theory of geographical distribution is perfectly harmless so long as you hold to good marketable securities for which there are official quotations. But there is very little in it. It is a mistake, of course, to keep all your money in one colony or foreign country, or in securities connected with one trade. But it would be silly to interpret the proverb about eggs so literally that one should make a special effort to scatter one's money in tiny parcels over the face of the globe.

Another important caution is to beware of shares not fully paid up. Many bank and insurance shares are of this description. The majority are safe; but the possible risk is too serious for any one of moderate means to undertake. On the other hand, good shares of this kind, with a liability of perhaps from 75 to 50 per cent., which might be called up in an emergency, yield a rather high rate of interest, and you can insure against a call at a very trifling expense. If you have insured yourself at Lloyds you can hold shares of this description and sleep on them comfortably.

Apart from circulars, the investor may easily be trapped by what he reads in newspapers, especially the concealed advertisements which often appear as articles in organs not known to be disreputable. Every one who has had any experience of the Press is aware of the difficulties, dangers, temptations and embarrassments by which its proprietors, managers and editors are surrounded. In Paris, if not elsewhere, there are newspapers (which may be politically square) whose financial columns are let to an advertising company! I do not know of any sovereign remedy. It is only by degrees that a reader can discover which papers are independent and which are not, which are flabbily optimistic, which are hopelessly and slavishly corrupt. Newspapers are apt to shift from one class to another as they change their proprietors, management, or staff. Sometimes a respectable journal, finding its advertising revenue dwindle, will abandon criticism of prospectuses, in order not to give offence. I am glad to think and

to feel sure that this policy is bad in the long run. The loss of reputation and interest will prove far worse for revenue than the slight temporary disadvantages which it is sought to obviate.

The three qualities an investor should demand and look for in his newspaper are—

1. Honesty, i.e. unpurchasable candour.
2. Sound information about conditions at home and abroad.
3. Criticism directed not merely to the dark side of the picture, but to all the considerations, good, bad and indifferent, which affect security values.

It is right that newspaper criticisms of City finance should err, if at all, on the side of pessimism. For the average reader errs on the other side. It is the green and greedy optimism of a speculative public that allows so many transparently false ventures to be successfully launched. If only the number of honest newspapers and of journalists financially competent could be multiplied in all parts of the world, vast sums now wasted could be saved, and many a rogue's avenue to affluence would be closed. To found and maintain a good newspaper is one of the most useful, public-spirited, and patriotic services that a man can perform. One of the marks of a good newspaper is that it publishes independent criticisms from its readers.

For the rest, the investor, having found his Stock Exchange, his broker, and his newspapers, and bearing in mind such precepts touching bonds, preference stocks, etc., as we have been able to

provide, will, if he be wise, above all remember not on any account to allow his investment to exceed his capital. The so-called investor who buys ten times more than he owns is a miserable, nervous and timid creature; for every movement in his 'investments' causes him ten times the amount of perturbation which it ought to cause him. He is always cutting losses, or jumping at small profits, instead of letting his original judgement stand. Besides, no investor, unless he be an absolute insider, could hope to make money after borrowing at 4 or 5 per cent. and paying commissions. It is like playing against the bank at Monte Carlo. The essence of investment is that it should be for long periods, with the reservation that the investor should keep a sufficiently close watch on his holding to be ready to take advantage of any substantial rise which, in his judgement, is not likely to last. People should take care to keep abreast of political and economic events in foreign countries in which they are financially interested. You may have holdings in Spain, Greece, Australia, Germany, Japan, China, or South America. In such cases you should keep an eye on communications in respectable newspapers dealing with affairs in these countries, more especially if they are critical. Rose-coloured accounts, accompanied by open or concealed advertising, are more than worthless. They rather provoke suspicion; for they suggest that a show of prosperity and strength is being made in London for the purpose of some impending credit operation.

CHAPTER X

THE LONDON STOCK EXCHANGE 1931–46

(By a Member of the House)

In September 1931 the National Coalition Government, which had been formed by Mr. Ramsay MacDonald to balance the Budget and maintain the gold bullion standard, decided to abandon gold and resort again to inconvertible paper money, thus resuming the system which had been adopted for the first time on the outbreak of the first Great War, and had continued for several years after its close. Mr. Philip Snowden was then Chancellor of the Exchequer, and Mr. Montagu Norman was Governor of the Bank of England. The decision to go off gold was accompanied by the creation of an Exchange Equalization Fund, to be operated by the Bank of England in order to stabilize what is still called Sterling but is in fact an inconvertible paper currency.

This divorce of sterling from gold, though associated with a dollar sterling rate and official rates with countries in the British Empire, had world-wide repercussions and naturally exerted a far-reaching influence on the London Stock Exchange. Fortunately the general public took this startling event calmly. Comparatively few of them understood the meaning of money. They were accustomed to use the pound and ten-shilling

notes, as the gold sovereign had not returned to circulation. The issue of the notes was restricted, and the effect of the change on prices did not manifest itself until the second Great War.

For a few days after this momentous decision the London Stock Exchange remained closed; but dealings were taking place in Throgmorton Street and between the officers and members. These informal dealings exhibited a general rise of prices, the upward trend being especially visible in gold shares and equities. Later on a second fillip was imparted to gold shares when the South African government, after a long period of hesitation, eventually decided to abandon the gold standard and lower the South African currency to a level with sterling.

Whatever may be said about the gold bullion standard its abandonment gave relief to the British taxpayer; for it made possible the biggest debt conversion ever undertaken by a British government. At that time there was still in existence the five-per-cent. War Loan amounting to over 2,000 millions sterling. As it was free of tax to persons resident abroad, it had created quite an army of foreign holders; and this class of investors had to be considered in any conversion operation, because every foreign holder could demand cash, and cash meant gold so long as sterling was on the gold bullion standard. After September 1931, sterling no longer meant gold. Hence, when the market saw that a conversion of the five-per-cent. loan to a lower rate of interest was not only possible but probable, all British funds began to appreciate, and

less than twelve months after the departure from gold conditions became ideal for a conversion offer to stock-holders. As was expected, the Government, in June 1932, notified its intention of redeeming the five-per-cent. War Loan at par on 1 December 1932. Holders of the stock were given the option of retaining their holdings in a three-and-a-half-per-cent. loan redeemable in 1952, or after. Those who elected to convert within two months were to receive a cash bonus of one per cent. Out of the total of over 2,000 millions all but about 300 millions was converted and a three-per-cent. loan was floated. The importance of this successful operation, quite apart from its relief to the Budget by reducing the debt charge, deserves emphasis. From 1919, after the end of the first World War, the yield of this five-per-cent. tax-free War Loan had been a yardstick by which other rates of interest in Great Britain, whether commercial, municipal, or governmental, were measured. And no doubt it also influenced rates of interest throughout the civilized world, because, with the exception of the United States, almost every foreign country had one or more loans outstanding in London and unless the country happened to be bankrupt the prices and yields of these loans were affected by the yield obtainable on the five-per-cent. British War Loan. Consequently, this conversion facilitated a lowering of interest rates abroad. It also engendered a spirit of confidence and optimism which to some extent compensated for the restrictive effects of the new British tariff and foreign retaliations on commerce.

This operation was also marked by an attempt at the dictation, now so frequent, by the Treasury and Bank of England to the City and private investors. In his announcement of the conversion the Chancellor of the Exchequer, Mr. Neville Chamberlain, expressed a hope that its success would not be impaired by the competition of other borrowers seeking accommodation. Here we have a precedent for Dr. Dalton's policies, to which he gave such outspoken expression during the debates on the nationalization of the Bank of England, showing his intention of controlling not only the Bank of England but also the Joint Stock Banks and private investors (in 1946), in order to carry out the Five-Year Plan.

The year 1931 was of course for financial institutions all over the world one of the stormiest on record. The economic blizzard which had started in Wall Street was blowing hard. Here the tempest increased in fury until September; and though it gradually subsided, unemployment continued, and even increased in 1932 and 1933. The first step of the Ramsay MacDonald Coalition government had been to balance the Budget, and this was accomplished heroically by Philip Snowden, who shortly afterwards, through ill-health, had to resign the Chancellorship and accept a peerage as Lord Privy Seal. The General Election gave the protectionist party a large majority in the House of Commons, of which Mr. Neville Chamberlain, the new Chancellor of the Exchequer, and Mr. Baldwin, took full advantage. The Prime Minister, Mr. Ramsay MacDonald, under this pressure accepted tariff

reform. A general tariff, followed by imperial preference under the Ottawa Agreements, was imposed, and this led to the resignation of Philip Snowden and most of the Liberal ministers. Meanwhile President Hoover raised the almost prohibitive tariff of the United States still higher, but the American situation got worse and worse and Mr. Hoover was heavily defeated by Mr. Franklin Roosevelt, who took drastic steps to restore the banking situation in the spring of 1932. His able Secretary of State, Mr. Cordell Hull, also exerted himself to reduce the American tariff by reciprocity agreements which, however, were largely frustrated by the strength of the protective interests in the United States and other countries. Consequently, international commerce and British overseas trade made only a comparatively small recovery; and in particular the great Lancashire cotton trade lost its supremacy in Far Eastern markets, and many losses were experienced by shareholders in these and other textile companies. After the collapse of Wall Street and of great banking concerns on the Continent it is not surprising that the financial blizzard was severely felt on the London Stock Exchange. Stock Exchange values crumbled in these years, as may be seen by the fact that the Index Number of the *Bankers' Magazine* declined from 127·3 in 1928 to 98·5 in 1931. British Railway stock and variable dividend securities were especially hard hit, but gold-mining shares rose during 1931. New issues of capital were on an exceptionally low scale, the year's total being only £88 millions. The prices of foreign bonds, in which we

had large investments, were naturally very vulnerable, and a multitude of unavoidable defaults gave opportunities and pretexts to suspend payments which were not lost by a number of South American countries such as Brazil, Chile, and Peru.

At this point it will be convenient and useful to trace the movement of our Stock Exchange prices between 1931 and 1945 by setting out the Security Index of the *Investors' Chronicle*, which takes 100 on 31 December 1923 as its basic figure, and classifies the leading stocks:—

INVESTORS' CHRONICLE SECURITY INDEX.

31 December 1923—100.

STOCK	1931 Dec.	1936 Dec.	1939 Dec.	1940 Dec.	1943 Dec.	1944 Dec.	1945 Dec.
Gilt-edged .	91.5	125·4	110·8	114·0	123·9	125·9	127·9
Fixed Interest .	86·3	133·9	111·9	100·3	135·8	140·1	135·9
British Railways Ordinary .	46·2	71·6	39·4	21·9	58·9	59·2	52·1
Banks . .	82·5	138·7	105·3	79·5	130·3	133·9	128·7
Insurance . .	100·8	191·3	131·6	98·7	146·4	159·8	172·1
Industrials .	73·7	145·7	94·3	65·9	133·4	149·8	158·2
Gold-mining .	94·7	255·1	190·4	154·2	156·3	153·5	162·6
Commodities and Land . .	51·4	135·9	105·6	65·7	101·5	109·3	119·6
Total Index .	71·4	138·5	101·9	75·3	125·4	136·5	143·1

A student examining the above table, who may think that there is a pure science of investment and speculation, should remember that the founders of economic philosophy rightly called it 'political economy' because even in the best of times eco-

nomic reasoning cannot be divorced from politics, and the wealth or poverty of a nation cannot be divorced from the foreign or domestic policy of its government. There is no institution more dependent on national and international policies than the London Stock Exchange, as any reader of this book will readily acknowledge. Only a well-equipped contemporary historian could explain why the Total Index ended in 1931 at the low level of 71, but afterwards kept above it with various ups and downs, and did not again fall so low, even in the year of Dunkirk, when it finished at 75. It is true that out of the eight groups comprising this Index four were lower in 1940 than in 1931—namely, Home Railways, Banks, Insurance, and Industrials.

Generally speaking, prices emerged from the slough of 1931, and climbed steadily until 1936, a turning-point being, as previously mentioned, the great conversion operation of the five-per-cent. War Loan in 1932. In these years there were indeed many depressing circumstances, such as the China 'incident', the rise of Hitler and German rearmament, the Abyssinian war, our own Abdication crisis and the Spanish war. The decline that set in at the end of 1936 and the beginning of 1937 can be explained by public realization of the menacing prospects in Europe which attacked vulnerable markets in London and New York. Although we escaped war at Munich, confidence quickly evaporated and prices continued to decline until the second Great War broke out over Poland in September 1939. In London the crisis

of our actual declaration of war on Germany (3 September) was surmounted with surprising smoothness. On 24 August the bank rate had been doubled from two to four per cent., and the sterling dollar exchange rate was reduced to 4·03. Minimum prices were imposed on the gilt-edged markets, and remained until the autumn of 1945, though by that time the minimum prices for Consols, etc., had long been left behind. There were no failures comparable to those of 1914. All Stock Exchange dealings were placed on a cash basis. The emergency was faced calmly. The bank rate was lowered to three per cent. on 28 September, and then to two per cent. on 26 October, where it remained throughout the War. So little were investors affected by this most terrible catastrophe that the general level of prices in December 1939 was not much below that of the year before. In the dark days of 1940 prices declined and were bumping along the bottom (in Stock Exchange parlance) until 1943, when a substantial recovery took place, which persisted with the achievement of victory in 1944 and 1945.

The Index Number reached its zenith in October 1945, in spite of the General Election. But in that month the optimism that followed victory with hopes of a real peace, rapid demobilization, and a return of liberty at home, began to yield ground before the advancing armies of State Socialism. The continued accumulation of debt through war-time expenditure and borrowing in time of peace, bureaucratic controls, and nationalization are naturally disliked in the City.

It is not my function to trace the terrible growth of the national debt, which rose more and more rapidly with unparalleled strides year after year in the War, with an ever-widening chasm between tax revenue and expenditure. In this way the national debt of £8,000 millions left by the first Great War has been more than trebled, and thus an avalanche of government securities has been descending on the Consol market in addition to the floating debt.

The new Labour Government under Mr. Attlee has only a share of responsibility for the war expenditure under the Churchill Coalition. But it is responsible for the estimates and expenditure of 1946–47, which were sanctioned by Dr. Dalton and passed by the House of Commons in February and March of 1946. They provide for a 'peace' expenditure of £4,000 millions which — unless there is some drastic change of policy—promises a further addition of about £1,000 millions to the national debt before the accounts for the financial year are wound up at the end of March 1947. It is not surprising that the City and the Stock Exchange are alarmed at the double prospect of inflation (i.e. a further reduction in the value of the pound sterling) and a continuance of severe taxation and burdensome controls of trade. An additional anxiety for the Stock Exchange and investors is that the Treasury and the Board of Trade under the direction of Dr. Dalton and Sir Stafford Cripps refused to reopen the Liverpool Cotton Exchange and other free markets.

On the Stock Exchange it is not believed that

the Chancellor of the Exchequer's efforts to manipulate the prices and yields of Government loans will succeed. It is hoped that he will turn the other way and put his trust in freedom. Certain restrictions could and should be relaxed without delay. A resumption of fortnightly settlements is long overdue. No one expects an early restoration of contango facilities; but the present system of cash dealings has a throttling effect on markets and discourages price-making, because the jobbers who quote the prices have so little opportunity to find buyers or sellers.

In 1939 The Prevention of Fraud (Investments) Act was passed. This was about ten years after an orgy of scandalous flotations and promotions had culminated in 1929. The intention of the Act was to suppress 'share-pushing'; but as the Act has only operated during the artificial war conditions one cannot predict whether it will succeed in eliminating the activities of bucket shops and 'white collar bandits'. Apparently some of them have migrated to Ulster, where the provisions of the Act do not apply. The Act also provided for the licensing of share dealers, unless they are members of a recognized Stock Exchange, and it requires deposits and guarantees.

Having noted the course of prices on the London Stock Exchange during the second World War, I turn to the question how the London Stock Exchange as an institution rode out the storm. An answer to this question is provided by a substantial pamphlet of eighty pages entitled *The Stock Exchange since 1939*, issued by the Council of

the Stock Exchange. Its salient points may now be summarized:

First of all the internal administration was fundamentally altered during the war, and from 25 March 1945 the Council of the Stock Exchange began to function through a Coalition of the Board of Trustees and Managers representing the Proprietors, and the Committee for General Purposes representing the Members. Sir R. B. Pearson, as Chairman of the Council, contributed an explanatory preface to the pamphlet, which he says 'is designed to give members and clerks returning to the Stock Exchange after long years of war duty some idea of the many changes that have taken place during their absence'. He proceeds to mention one event of great importance. 'In June 1943 the President of the Board of Trade set up a Committee (under the Chairmanship of Mr. Justice Cohen) to consider and report what major amendments were desirable in the Companies Act, 1929, and in particular to review the requirements prescribed in regard to the formation and affairs of companies and the safeguards afforded for investors and for the public interest.'

A great number of important bodies and persons, including the Committee for General Purposes of the Stock Exchange, as it then was, submitted their views in writing and subsequently gave oral evidence. Two years later, in June 1945, the Cohen Committee published its Report, in which the majority of the reforms suggested by the Stock Exchange were adopted, while in other cases the Committee, while of opinion that our suggestions were of value, took the view that they were more suited for administration by the elastic machinery of the Stock Exchange than for embodiment in new legislation.

This official recognition of the position of the Stock

Exchange as a guardian of the public, especially through its control over the admission of New Issues to the market, firmly establishes our status as a public institution conscientiously carrying out its public functions.

The principal change affecting the day-to-day procedure of buying and selling securities was the regulation that all dealing should be for cash or immediate settlement instead of for the account. This did not affect the gilt-edged market because transactions in British funds and kindred stocks are normally for cash. 'Immediately upon the outbreak of war the Committee passed a whole series of Temporary Regulations (after consultation with the Treasury and the Bank), covering the closing of the House, the substitution of cash for account dealings, the establishment of minimum prices, the prohibition of dealings in New Issues without prior Treasury consent, trading with the enemy, etc.' The pamphlet expresses the hope that 'these Temporary Regulations will be rescinded in the not too distant future and the various restrictions on dealings will be cleared away; but no indication can be given at present when this will be'.

The old legal maxim of *caveat emptor* (which means that the buyer must look after himself) has been steadily watered down during the period since the boom and slump of 1929. The buyer must still beware, but the Committee have continually tightened up the rules with the object of protecting the public from its own errors of judgement and from the depredations of financial sharks. A new Rule lays down that a Member, attaché, or clerk must obtain the Council's permission before contributing financial articles regularly to the Press. Permission so granted is subject to annual

renewal and may be withdrawn at any time. The observation is made that 'where the same person exercises the dual function of a Member of the Stock Exchange and a journalist there is always the possibility that his dual position may produce biased comment. It has occurred in the past that writers of columns dealing with possible investments have at times shown more enthusiasm than good sense. The view has been taken that, while in the main journalists in the House provide a most useful service to the Press and the public, the Stock Exchange would do well to keep a list of members and clerks engaging in such activities so that in the event of criticism the writer can be asked for an explanation.' The phrase 'more enthusiasm than good sense' is certainly not an overstatement.

It is in the field of new issues and permission to deal that the Stock Exchange has made the greatest advance for the protection of the public. 'As a result of the 1928 boom and the subsequent slump in 1929, aggravated by the Hatry crash, the Committee for General Purposes set to work and completely remodelled the permission to deal rules. These were adopted in 1930.' This thoroughgoing reform made the provisions of the Stock Exchange Rules more stringent in some instances than those of the Companies Act. A further internal reform was the setting up of the Records Department, which maintains files on all financial operations and personalities. The combined effect of the new rules and the activities of the Records Department has been to place considerable obstacles in the way of undesirable promotions and almost completely

to stamp out bad underwriting. It is worthy of note that the Stock Exchange set up this elaborate new issues control entirely on its own initiative, and operates it in the interests of the general public at its own expense. The change in attitude to new issues is best shown by comparison. Before 1914 the official Stock Exchange view was that the only important thing about a security was whether it was freely marketable or not. Its merits or demerits were of no concern. In June 1945, a Member who brought to the New Issues Committee an application for permission to deal in the securities of a company which he knew had not a good reputation, and who failed to take the step of consulting the Records Department, incurred the 'severe censure' of the Council. Owing to this concern for the protection of the public the Cohen Committee could report that several reforms which they thought desirable and necessary in the public interest would be best carried out not by legislation, but by the flexible machinery of the Stock Exchange. Generally speaking, in case of a security 'of sufficient magnitude and importance' in which there is enough public interest, an application for permission to deal and for a quotation should be considered on its merits.

The paper shortage has caused a cut in the size of the Official and Unofficial List. Bargains in inactive stocks now appear in a Monthly Supplement.

In the pamphlet from which I have been quoting it is pointed out that 'the practice of returning to agents who introduce business to the Stock Exchange a portion of the commission charged

thereon is a very old one, and goes back at least to the foundation of the Joint Stock Banks around 1830'. Until 1932 all agents received half the commission charge; but in that year the custom was altered by regulation, and further changes were made in 1941. The position now (1946) is that a commission may be returned as to one-half, one-third, or one-quarter, according to the class into which the agent falls. A London or provincial broker receives half. Banks, remisiers (i.e. agents resident abroad), attachés, clerks, and Imperial brokers receive one - third, while any other agent receives one - quarter. With the exception of British and Imperial brokers all agents must be registered with the Council, and all except banks pay an annual registration fee varying from one to five guineas. A London broker is now allowed to deal in a local stock on a local exchange if the price is the same as in London.

Immediately the second Great War started, and partially before it started, there was a considerable exodus of members and clerks from the London Stock Exchange into the armed forces, or to take up work of national importance. Consequently, Resolutions were passed to protect the interests and status of both members and clerks. An interesting innovation is the Rule providing for Corporate Members, the main reason for which was the excessive burden of taxation. The Council refer thus to this new departure: 'Representations were made to the Board of Inland Revenue that during recent years the severity and inequity of the effects of existing methods of direct taxation

on violently fluctuating incomes, such as are the frequent experience of Members of the Stock Exchange, produced considerable hardships. In the case of Jobbers the position was made worse by the liability incurred to pay tax on unrealized and frequently unrealizable profits, arising out of writing up book values to the market prices for the purpose of arriving at taxable income.' The situation had arisen when Jobbers were forced to face the fact that a period of very active and rising markets constitutes as great or an even greater menace than one of falling markets. The Board of Inland Revenue indicated to the Stock Exchange representatives that the only way in which relief could be obtained was for the Stock Exchange to follow modern practice and allow firms to register themselves as private companies with unlimited liability. The relief worked in the following way:

'Under the existing law the whole of the profits of a firm, as computed for purposes of Income Tax, falls to be treated as the income of the Members of the firm in computing their total income for the purposes of surtax, whereas in the case of a private company the proportion of profits placed to reserves would not be liable to surtax providing that there had been a reasonable distribution of the profits by way of dividend or otherwise as income of the shareholders. It was clear, therefore, that the proposals were in the interest of Members and the public, as an accumulation of reserves would not only increase the stability of the House but also contribute materially to the freedom of markets. When these Rules were passed it was

thought that they would be largely taken advantage of by Jobbers; but the first application was in fact made by a firm of brokers.' Membership of such a company is of course restricted to full Members of the Stock Exchange. 'A Corporate Member pays no entrance fee and only a nominal subscription; has no right of nomination, and cannot act as a surety, or vote at a meeting of members. It is therefore no more than a convenient piece of machinery which enables Stock Exchange firms to qualify for certain tax advantages which the Board of Inland Revenue has agreed it is equitable for them to have.'

So much for the present state and status of the London Stock Exchange. What will be the ultimate effect of Dr. Dalton's measures for nationalizing the Bank of England and of the Investment Control and Guarantees Bill, which was introduced by the Chancellor of the Exchequer and severely criticized by the Opposition, on 5 February 1946 (see the report in Hansard), it is quite impossible to say. The object of the Investment Bill, according to Dr. Dalton, is 'to control the flow and the direction of new investments'. It is a part of his 'streamlined legislation', and its main purpose is 'to ensure that the order of priority of schemes for raising new capital shall be determined by one criterion only, namely their relative importance in the general national interest'.

It is difficult to see how any Chancellor of the Exchequer with a national debt of 25,000 millions or more, who wants to borrow, could get on without the London Stock Exchange.

GLOSSARY

ACCOUNT DAY.—The last of the four days on which London Stock Exchange bargains are settled.

ALLOTMENT.—When a new loan is issued to the public, subscriptions are invited. If the loan has not been oversubscribed the applicants receive allotment in full. If it has been oversubscribed the amount has to be allotted, or divided up, among the applicants.

ARBITRAGE.—Stock Exchange transactions between two countries. If the same stock is cheaper in New York than in London it may pay a London operator to execute an order in New York, and vice versa. Similar transactions between the London and the Provincial Stock Exchanges are called shunting.

BEAR.—An operator who sells 'short', with a view to repurchasing at a profit.

BONDS.—Securities representing the debts of a public authority or of a company, and in the latter case often secured by a mortgage. They are usually to 'bearer', with interest coupons attached, and are transferable by delivery.

BROKER.—This term is used in a special sense for a member of the London Stock Exchange who buys or sells securities for the public, from or to the jobber.

BUCKET SHOP.—A term of reproach sometimes applied generally to all outside brokers not connected with a Stock Exchange. Some are unloading shops which advertise to catch investors; others are gambling shops which offer facilities to speculators.

BULL.—An operator who buys stock for which he does not mean to pay, with a view to reselling at a profit.

BULLION.—Gold or silver in bars.

CARRY OVER.—The continuation of speculative bargains from one account to another on the London Stock Exchange.

COUPONS.—Interest tickets attached to bonds, which the owner cuts off from time to time as they become due for payment.

DEALER.—*See* Jobber.

DEBENTURES.—A general term for bonds, but not necessarily or usually including a mortgage. It usually means a floating charge on the assets of a company. The leading English debentures are the debenture stock of English railways. In case of default on interest the debenture holders (though there is no mortgage on the line) can put the property in the hands of a receiver.

DEFERRED STOCKS.—Stocks which can only receive interest after a dividend has been paid on preference and preferred ordinary.

DIVIDEND.—Divisible profit; the interest declared from time to time by a company on its shares, and paid to its shareholders.

GILT-EDGED SECURITIES.—A term applied to Consols and other first-class securities which are regarded as quite safe.

JOBBER.—Jobbers, or dealers, are members of the London Stock Exchange who stand in the house and 'make prices', buying from, or selling to, the brokers.

KAFFIRS.—The Stock Exchange name for South African mining shares.

LIABILITY.—For shares not fully paid up the holder is liable in case the company fails or requires more capital. Thus, on a ten-pound share, with one pound paid, the liability is nine pounds.

LIQUIDATION.—The winding up of a company in bankruptcy. To liquidate is to realize or sell out securities. A liquid asset is a security which can easily and quickly be turned into cash.

MARGIN.—The excess percentage over and above the market price of a security deposited with a banker in return for a loan. Thus a banker may require a

five per cent. margin of protection on Consols, and ten per cent. on railway stocks. Margin is sometimes called 'cover'. When a security depreciates and the margin runs off, more cover is required, otherwise the security will be sold.

OPTIONS.—(*See* pp. 151, 152.)

ORDINARY OR COMMON STOCK.—The lowest class of security except where deferred stock has been issued. Ordinary ranks after preference, as preference ranks after debenture for interest.

PAR VALUE.—The face value of a stock. The par value of a ten-pound share is £10, that of a hundred-pound share £100.

PREFERENCE OR PREFERRED STOCK.—Securities which rank before ordinary or common stock for dividend.

PROSPECTUS.—A published invitation to the public to invest in a new loan or company.

PUT AND CALL.—(*See* p. 152.)

RENTE.—A French term for debt or public funds. French *rentes* are the equivalent of British Consols.

SCRIP.—The paper receipt for a new security, on which only one or two instalments have been paid.

SHORT.—Selling 'short', i.e. selling what one has not got. (*See* Bear.)

SINKING FUND.—A fund set apart for the redemption of debt.

TRUSTEE STOCKS. — Securities in which Trustees are authorized by law to invest.

TURN.—The jobber's turn is the difference between the prices at which he will buy and sell a security.

UNDERWRITING.—An agreement to take a new capital issue at a price below that at which it is offered to the public. The discount is the underwriter's commission.

WATERED STOCK.—A company which increases its nominal capital without improving its assets is said to water its stock.

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INDEX

OF SELECTED TOPICS

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